INTERNATIONAL TAXATION AND FEMA KAL – AAJ – AUR – KAL

DILIP J. THAKKAR
Chartered Accountant

When I qualified as a Chartered Accountant way back in 1961, the words 'International Taxation' were not known to Chartered Accountants. The reason is not difficult to find.

Our country had an acute shortage of foreign exchange. Hence the British Government, who ruled our country before 1947, imposed exchange control regulations as a temporary measure at the time of the Second World War through the Defence of India Rules in 1939. Though it was meant to be a temporary measure to fight the War, its continued need was felt and hence it was made permanent by legislating the Foreign Exchange Regulation Act, 1947. It was a very loose piece of legislation, not precise, leaving a lot to interpretations.

After the experience gained over 26 years, the 1947 Act was replaced by the Foreign Exchange Regulation Act, 1973 (FERA) which came into force from 1st January, 1974.

Because of acute foreign exchange resources of the country, there were very few inward foreign investments and hardly any outbound foreign investments and that too, confined to a few high and mighty, the rich and the famous.

When I passed my final CA examination of November, 1960, the subject of foreign exchange and/or international taxation was not on the CA curriculum. Hence, there were hardly any tax professionals, aware of and practising international taxation and foreign exchange regulations.

FERA, 1973 was a draconian, criminal law in which *mens rea*, meaning guilty mind, was presumed. One was presumed to be guilty until one proved oneself to be innocent – completely contrary to the established principles of jurisprudence. For every need of foreign exchange, including for legitimate foreign travel, one had to approach the Reserve Bank of India (RBI) for release of foreign exchange. If one asked for release of foreign exchange for five days, RBI would give sanction for three days. There were instances when during a week of foreign travel, there was Saturday and Sunday in between; in such cases RBI would rather want one to come back on Saturday morning and go back on Monday morning and sanction foreign exchange accordingly! Coupled with shortage of foreign exchange, there was what was known as requirement of 'P' form; meaning to get approval for booking your passage or ticket for going abroad; and chances of getting that were better if one preferred to fly Air India. Later, the foreign exchange quota was relaxed by allowing first a lump sum of USD 100, later increased to USD 500 for a foreign trip, irrespective of its duration. People used to book an excursion ticket by Air India, which was valid for four months, avail of the sumptuous allowance of USD 500 and go abroad. This was nothing but official invitation to contravene FERA as such people used to make other arrangements for their requirement of foreign exchange. The law was so impractical that the then Prime Minister had gone on public record saying that offering a cup of tea to a Non-Resident by a Resident would amount to contravention of FERA. Since then, we have come a long way. Now, not only a cup of tea but complete hospitality to a non-resident is permitted.

The real breakthrough came in July of 1991 when our foreign exchange reserves were as low as approximately USD 1.1 million, hardly enough for fifteen days' imports. The country would have literally gone bankrupt but for the timely action by the then Finance Minister, Dr. Manmohan Singh, who pledged the country's gold with IMF, announced sweeping reforms and saved the country from international shame.

As a result of such reforms, foreign exchange reserves gradually increased and both inbound and outbound foreign investments increased gradually. This started the awareness about foreign exchange regulations, double taxation avoidance agreements and international taxation amongst the tax professionals. One saw a gradual increase in seminars and conferences with FERA and International Taxation as subjects for discussions.

As per the experience gained over another 26 years, the

Foreign Exchange Regulations Act, 1973 (FERA) was completely replaced by the Foreign Exchange Management Act, 1999 (FEMA) which came into force on 1st June, 2000. FEMA has been a civil law, which is more precise and comparatively easy to understand and implement. Under FERA, all transactions in foreign exchange and dealings with Non-Residents were prohibited unless permitted by RBI. Under FEMA, all Current Account transactions are freely permitted under the automatic route except for a very few requiring RBI permission but all Capital Account transactions are prohibited unless permitted by RBI.

This opened up the floodgates of professional opportunities for tax professionals and Foreign Direct Investments into India and India's investments overseas have considerably increased, resulting in the present foreign exchange reserves of the country in excess of USD 390 billion. Now the tax professionals have understood the importance of International Taxation and its potential for professional practice. The need is further strengthened with the introduction of Transfer Pricing Regulations in our tax laws from 2001.

Since June, 2000, the law in force is Foreign Exchange Management Act, 1999 (FEMA). Hence the emphasis is more on management of foreign exchange rather than regulation of foreign exchange. Hence, RBI has, since February, 2004, introduced the Liberalised Remittance Scheme (LRS) permitting residents to access a certain amount of foreign exchange for their personal needs like foreign travel, education, medical expenses, etc. The LRS scheme started with a small quota of USD 25,000 to each resident to invest abroad, open a bank account overseas etc. which gradually increased to USD 50,000, USD 100,000, USD 1,25,000 reduced to USD 75,000 for a short period and increased to USD 2,50,000 at which it has now stabilised. Of course, the LRS scheme has brought in its wake new problems but it is more or less successful.

Now the tax professionals have come to know the role of OECD in the realm of International Taxation and now we find many such professionals practising International Taxation and FEMA and also sharing their knowledge at conferences and seminars. Study of international taxation, FEMA and DTAA have opened up certain limited opportunities for international tax planning but one has to do so very cautiously due to concepts and regulations like GAAR, POEM, BEPS, MLI, TP, Permanent Establishment, etc. The matter has become more complicated with the coming into play of FATCA and CRS which have set into action, automatic exchange of information globally.

Over and above the Article for Exchange of Information contained in the Double Taxation Avoidance Agreements (DTAA) that our country has entered into with several countries, since many so-called tax haven countries were excluded or were not inclined to enter into such agreements, now our Government has proactively entered into Tax Information Exchange Agreements (TIEA) and also Multilateral Convention on Mutual Administrative Assistance in the matter of Taxation with many other countries.

These have resulted in our country being able to obtain tax information from all these countries. Moreover, because of the Foreign Account Tax Compliance Act (FATCA) of USA and the Common Reporting Standard (CRS) adopted by many other countries resulting in automatic exchange of information, a lot of information relating to beneficial owners of overseas assets and income has started flowing in, resulting in Tax Department and Enforcement Directorate initiating investigation against persons concerned. As a result of all these steps, more and more persons have been adversely affected by the crackdown on offshore tax havens.

All these, coupled with Black Money (Undisclosed Foreign Income and Assets) And Imposition of Tax Act, 2015 (BMA), have opened up immense professional opportunities and challenges for tax professionals provided they have sharpened their skills in the fields of international taxation and exchange control regulations. This may also have implications of taxation in multiple countries requiring filing of tax returns in other countries and paying taxes there. This will necessitate the need to claim foreign tax credit in the country of residence in respect of taxes paid in the source country. Many tax professionals must have already experienced the impact of automatic exchange of information in respect of their clients.

One important facility in International Taxation is the permission to Chartered Accountants by CBDT and RBI to issue withholding tax certificate in Form 15CB for making overseas remittances. This is very much appreciated by all concerned as it, being prompt and professional, saves time in making remittances.

However, one negative in the matter of International Taxation is the attitude of Authorised Dealer Banks. RBI has delegated many powers to banks and everything has to be routed through banks only. But their lack of knowledge hampers and delays the process. Today, a professional who is able to advise clients in the matter of International Taxation is much more respected than one who confines to auditing and domestic taxation because of the opportunities thrown open to corporates and entrepreneurs. Now it is no more confined to the high and mighty, the rich and famous. The tax professionals are experiencing many inquiries from common businessmen for advice on overseas structures and regulations concerning the same.

The term, Base Erosion and Profit Shifting (BEPS) has now become an important topic for discussions and consideration amongst tax professionals globally and has made inroads into India also. The general tendency amongst businessmen and industrialists is to look for low tax or no tax countries to shift their activities. Hence, the existence of tax havens became very relevant in the last few decades. The profits are artificially shifted to such low-tax or no-tax jurisdictions. This brings out the issue of form over substance as such activities do not have much substance. This, in short, is known as BEPS.

In recent times the world has become more transparent in terms of commercial and economic activities. The tax havens which had no Double Taxation Avoidance Agreement with any country have now given up because of the fear of extinction and have signed tax information treaties with all major countries. Frankly, tax haven has now become a dirty word, as it immediately smells of tax evasion. Treaty abuse had become rampant and to control the same, OECD formulated Multilateral Instruments (MLI) with a view to modify bilateral tax treaties and arrest treaty abuse.

Another avenue of international tax planning which had become very popular was cross-border offshore Trusts for tax saving and estate planning. It is always a fact that businessmen and entrepreneurs are very quick in understanding and implementing such measures while the laws and tax authorities are very slow in understanding such loopholes and catching up with legislation to counter them. This leads to changes in domestic laws to make such tax-planning measures very expensive and even useless. There was a time when offshore Discretionary Trusts settled by Non-Resident relatives for the benefit of their Resident relatives in India were very popular because any capital distribution by such Trusts was exempt in the hands of such beneficiaries. Moreover, the banking secrecy laws of jurisdictions like Switzerland, the Channel Islands etc., helped proliferation of such Trusts. But now, with global awareness about their abuse for tax planning, coupled with the KYC requirement regarding the ultimate beneficial owner (UBO), has led to amendments in domestic laws making such Trusts almost redundant.

Now that we Indians are allowed to own assets worldwide, the importance of International Taxation has gained considerable importance. The issue of Cross-Border Wills or Wills for overseas assets also opens up avenues for international tax practice. One lesser known area is the GST impact on cross-border transactions. Its impact on import and export of goods and services, stock transfers, international trading, projects outside India etc., needs careful consideration as a part of International Taxation.

One important issue that seems to have escaped attention of the tax professionals and the authorities concerned needs to be resolved. It is about the fact that when the Enforcement Directorate (ED) concludes an investigation, even after adjudicating process, no order is issued when it is in favour of the person concerned but invariably an order is issued when the same is against the person and a penalty is levied. It is well-known that under FEMA, there is no limitation period prescribed but even then, there should be a regulation to provide for a discipline of time limit within which an order, whether adverse or favourable, must be issued by ED after completion of the hearing. We find this very common under all other laws that an order is invariably issued, whether in favour or against, within a reasonable time after the hearing is over. Even taking an example under FEMA, the law provides that the hearing of a compounding application must be completed within 180 days and thereafter an order is invariably issued within a maximum of one month. Why shouldn't the same be made applicable to the ED?

All these developments in the arena of International Taxation and FEMA would mean that specialisation is the only way for tax professionals to survive, succeed and prosper. The days of Jack of All and Master of None are now over. Now we have not only to look to the present but to think of the future and equip ourselves to understand events happening globally in the fields of economic activities, reforms and international taxation. However, the future lies in complete removal of exchange control regulations. We have the examples of England and Singapore and how they have progressed and flourished as financial centres after abolishing exchange control regulations. ■