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Glimpse on companies tax avoidance, tax evasion and tax haven

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Abstract
Tax planning is allowed provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is considered to be wrong to encourage to avoid the payment of tax by dubious methods. Tax avoidance and tax evasion has not been defined under any Act; still they have prominence in the economy. Both terms can be understood through interpretation provided by court through cases.
Most nations face the problem of tax avoidance and tax evasion. Such practices may lead to - substantial loss of much needed public revenue, increase in black money directly causing inflation, shifting burden of tax liability from tax dodgers and other consequences.
As per section 2(17) of Income Tax Act 1961, a company means Indian Company or body corporate incorporate under the laws of a country outside India. Thus, a company whether Foreign or Domestic Company is liable to pay tax.
Generally corporates avoids tax payment by investing through special purpose vehicle or entering into complex business structures. Government of India has taken initiative to lessen the scope of tax avoidance and tax evasion.
Corporate tax: According to the income tax slab for assessment year 2017-2018, domestic company is liable to pay tax at 30%. But a tax rate at 25% is applicable if turnover does not exceed Rs. 50 crores (including surcharge and education cess). Whereas, foreign company is liable to pay at the rate of 40% including surcharge and education cess.

Keywords: Tax avoidance, tax evasion, tax haven, penalties

1. Introduction

Income tax rates are directly related with the degree of tax avoidance an evasion by the individual tax payers. The basic idea is that as income tax rises, the assessee tries to adjust their economic affairs so that they can reduce their taxable income in such a manner to reduce tax liability. The attempt to:

- Substitute non-taxable income for taxable income;
- Claiming exaggerated sum by way of tax-free deductions and allowances constitutes tax avoidance methods. The scope of tax avoidance depends upon the provisions of Income Tax Act 1961.

Some of the contentions provided by corporates for avoiding tax is that they would like to pay more salary to employees, more travel expenses on foreign tour, more tax free reimbursement of expenditure on furniture, furnishings to officers, etc. merely revising rates by Finance Act cannot resolve the problem and such ad hoc handling of tax policy leads to inflationary trends in the country. Thus, full implications and feasibility of any tax policy could be considered by economists or experts before imposing tax rates.

There has been various cases in which company has engaged in indirect transfer so as to avoid taxation. Prominent amongst them is *Vodafone International Holdings BV v. Union of India* [1] case, in which Supreme Court held that Vodafone was not liable to tax.

Number of legal issues were dealt by Supreme Court in respect of:

- Piercing of corporate veil: Piercing of corporate veil is a doctrine wherein the legal fiction of company as a juristic person is recognised so as to separate rights and liabilities of the company from its shareholders. Court has authority to lift corporate veil, if a transaction is proved to be fraudulent or as a device which is against the interest of shareholders, investors. It can be applied in case of holding-subsidiary company relationship, in case facts reveal that they are indulge in dubious methods.
- Tax avoidance: 'Tax Avoidance' has no definition either in Companies Act 1956 or Income Tax Act 1961. Sale of CGP was not the consequence of an artificial tax avoidance scheme, preordained with the sole object of tax avoidance, but was a genuine commercial decision to exit from Indian telecom sector.
- Whether Section 9 of the Act 1961 [2] is a 'look through' provision: Section 9(1) (i) cannot by interpretation be extended to cover indirect transfers of capital assets/property situated in India. Revenue contented in present case that the said section covers the transfer of shares of a foreign company holding shares in an Indian company and treat transfer of shares of the foreign company as equivalent to transfer of shares of the Indian company. But, SC finally concluded that Section 9(1) (i) of the Income Tax 1961 has no "look through" and such a provision in a treaty or statute is a matter of policy.
- Withholding tax obligations under Income Tax Act: CGP share was transferred between companies incorporated outside India. Both companies have no

[1] Vodafone International Holdings BV Vs Union of India (UOI) and Anr (2012) MANU/SC/0051/2012 (SC).

[2] 'Income Tax Act, 1961'.

income in India. SC held that Section 195 would only apply if payments are made from a resident to another resident and not between two non-residents situated outside India. Thus, the transaction in question has no nexus with underlying asses in India.

Thus, the court held that the transaction was between two non-resident entities through a entering into contract outside India. Consideration was also passed outside India, such a transaction has no nexus with the underlying assets in India.
In case of *M/s. Sanofi Pasteur Holding SA vs. The Department of Revenue Ministry of Finance*, [3] the Andhra Pradesh High Court held that capital gains arising from transfer of shares of a non-resident company between two non-residents not taxable in India and lifting corporate veil is not warranted.
Main issues raised:

- Was investment made by GIMD & MA in SBL is a colourable device which is aimed for the avoidance of tax?
- Is ShanH has any commercial substance regarding the corporate status
- Is transaction liable to be taxed under Act and DTAA?

Andhra Pradesh high court held

- ShanH, though wholly owned subsidiary of MA, evolved into joint venture entity of MA/GIMD – is not sham, illegal or illusionary.
- ShanH is an entity of economic substance and business purpose and is not just nominee of MA/GIMD. Hence, ShanH is the beneficial and true owner of SBL shares.
- Even on piercing the corporate veil of ShanH, the transaction in issue is clearly one of the transfer by MA/GIMD of their ShanH shareholding to Sanofi.
- Subsequent to transaction, ShanH continues to be French organisation and as legal and owner of SBL shares – transaction is one of the entire shareholding in ShanH by MA/GIMD in favour of Sanofi, thus transfer of SBL shares in favour of Sanofi is neither intent nor the effect of transaction.
- The transaction in issue is of alienation of ShanH shares and not transfer of shares or of control, management or underlying assets of SBL.
- The resulting Capital gain tax is allocated under article 14(5) of DTAA. Hence, liability arises in France, not in India.
- The order of assessment, determining Sanofi to be an assessee in default under section 201 is unsustainable [4].

2. Tax evasion by companies

The concept of taxable income is different from book profits, this results companies with tax avoidance. Taxable income equals to book profits [5] plus disallowances minus non-book allowances. Higher the tax rate, greater might be temptation of corporates to widen the scope of tax concession. Company might to try to plan their present and future activities in such a way to minimise tax disallowance and maximise tax allowances.

Instances for tax evasion

- Claiming depreciation and investment allowance on inflated ‘actual cost’,
- Reimbursing expenditure on furnishings, medical, travel expenses by the Directors or employees,
- Payment of foreign travel expenses of Directors classifying as business tour,
- Shares of company held under blank transfers or benami names
- not disclosing investment made out of concealed profits or dividend income,
- Classifying expenses on servants, vehicles, phones, etc.,

Above are some common examples employed by company, whether it is a question of fact or law, they can be challenged in the courts of law, brought in dispute by assessing officers.
In case of *CIT v Sati Oil Udyog Limited and anr* [6], the question in relation to constitutional validity of the retrospective amendment to Section 143(1-A) of Income Tax Act 1961 was raised.

Major issues were

- When is it permissible to invoke additional income tax under section 143(1-A)
- Scope and object of section 143(1-A)
- Validity of retrospective effect of 1993 amendment for imposition of additional tax for AY 1989-1990, 1991-1992

In the instant case Supreme Court held that, the object of section 143(1-A) of the Act 1961 is the prevention of evasion of tax. This provision provides that “persons who have filed returns in which they have sought to evade the tax properly payable by them is meant to have deterrent effect and a hefty amount of 20% as additional tax is payable on difference between what is declared in the return and what is assessed to tax.
The “total income” referred in provision is wide enough to include both profits and losses. Thus, additional tax is imposable on losses as well.
Section 143(1-A) can only be invoked if it is found that the lesser amount stated in the return is a result of an attempt to evade tax lawfully payable by assessee. The burden of proving is on the Revenue by establishing facts and circumstances from which reasonable inference can be drawn [7].

2.1 Penal provisions under income tax act, 1961

Since, tax evasion is a criminal offence in India and attract penal provisions given under Chapter XXII of the Income Tax Act, 1961.
Following are few penal provisions attracted for evasion of tax

- Section 276C is imposed in case of wilful attempt to evade tax. Thus if underreported income is ₹ 25,00,000, there will be rigorous imprisonment for a term not less than 6 months extendable to 7 years with fine. In other cases, the imprisonment is not less than 3 months which

[3] Sanofi Pasteur Holding SA v Department of Revenue and others [2013] Hyderabad HC 2013 SCC OnLine AP 422.
[4] ibid.
[5] ‘Book Profit means the Net Profit as shown in the Profit & Loss account for the year.’
[6] Commissioner of Income Tax and Ors vs Sati Oil Udyog Ltd and Ors [2015] SC MANU/SC/0334/.
[7] ibid.

is extendable to 2 years [8].

- Section 278B: Where an offence committed by a company, every person, at the time of offence committed, was responsible for the conduct of the business of company, shall be deemed to be guilty of the offence and shall be punished accordingly.

Provided that such company shall be punished with fine and every person including director, manager, secretary or any other officer referred under this section [9].

The use of Information technology has been growing in tax administration. Tax e-payment and e-filing is a prominent facility provided to the taxpayers to make income tax through banking or by use of debit/credit cards. Assessee are required to get their accounts audited under section 44AB and all companies are required to mandatorily make e-tax payment.

2.2 Difference between tax avoidance and tax evasion

Meaning: Tax avoidance is considered to be legal mechanism to reduce tax liability, which would be otherwise incurred, by taking advantage of some provision or lack of provision in the law. In contrast, tax evasion occurs when the taxpayer fraudulently or criminally avoids the payment of taxes otherwise due or owing under the tax laws.

Outcome: In tax avoidance there is legal exploitation of tax laws to one's own advantage. When tax payer pays less than he is legally obligated or pays by hiding income or information from tax authority is tax evasion.

Examples: Tax avoidance would arise – like establishing offshore units in tax havens and channelizing profits through them or carrying out transactions through offshore subsidiaries to avoid taxes in India. Tax evasion involves – stating untrue statement, submitting misleading documents, suppression of facts.

Thus, tax avoidance is within the boundaries of law but it defeats the purpose of laws and regulations by eliminating their very spirit. Whereas, tax evasion is considered to be criminal activity and thus attracts penal provisions given under The Act 1961.

3. Tax Havens: Vehicle for Tax Avoidance/Tax Evasion

Tax haven has no precise definition. Though OECD has provided the features of tax havens:

- No or less taxes
- Lack of effective exchange of banking and financial information.
- Lack of transparency
- No requirement of substantial activity

In common parlance developing countries are attracted towards tax haven nations. Such jurisdictions are used to conceal the business activities, thereby, promoting criminal and terrorist related activities. It may even lead to 'money laundering', since there is no track for earning and transferring of money. Meanwhile, it is considered to be legal on the ground that a nation providing tax benefits and other financial benefits, cannot be declared as illegal. There are several companies who use tax havens to evade their liability in following manner [10];

By forming shell companies: Shell Companies has not been defined under any Act. Generally, companies formed having no operations. In India, government has notified new limits for companies establishing two layers of subsidiary companies. The government views shell companies primarily as vehicles of illegal financial manipulation – that has been established for the sake of diversion of funds and money laundering to evade taxes [11].

Transfer pricing: It means fixing the price of goods, machinery or services between two related companies. Transfer pricing has been used as vehicle through which corporations are shifting their income to low-tax jurisdictions and in some cases no-tax jurisdictions. As business evolves, more and more complex business transactions are created, and lack of adequate legislation to prevent these transactions, creates an opportunity for excessively aggressive tax avoidance. Although transfer pricing laws have been enumerated under Section 92 to 2F of Income Tax Act 1961 – covers intra from cross-border transactions [12].

Some of the examples of tax havens are: Bermuda, Cayman Island, Netherlands, Singapore, Mauritius and some others. These countries are considered to be hub of MNEs subsidiaries which has low tax and financial secrecy.

4. Measures to control 'tax avoidance' and 'tax evasion'

1. Place of Effective Management (POEM)

CBDT has finalised the guidelines for POEM regulations in India – applicable for AY 2017-2018. The purpose of this principles to decide the residential status of the company. One of its unique feature is - Active Business Outside India (ABOI) – to target shell companies or companies created for retaining income outside India although real control and management of affairs is located in India [13].

2. General Anti-Avoidance Rule

There is a difference between tax evasion and tax avoidance. Tax evasion is completely outside the purview of tax law and hence not permitted. Tax avoidance is restructuring the financial position of entity in such a manner so to lower tax liability. GAAR was introduced to curb tax avoidance. Thus, it prohibits those structures or arrangements that has been executed only for the purpose to avoid tax.

Chapter XA has been introduced in Income Tax act 1961, effective from April 1, 2017. Section 95 to 102 deals with the provisions of GAAR. GAAR is applicable when an 'arrangement' is declared to be *'impermissible avoidance arrangement'*. Where arrangement means any scheme, agreement, transaction or understanding that includes any alienation of property [14].

Section 96 of The Act enumerates the essential ingredients constituting 'impermissible avoidance arrangement'. Thus, an arrangement is said to be impermissible avoidance arrangement, when there is a presence of any of the

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[8] 'Inserted by the Finance Act, 2016, w.e.f. 1-4-2017.'

[9] 'Income Tax Act, 1961'.

[10] Jane G Gravelle, 'Tax Havens: International Tax Avoidance and Evasion' (2009) 62 National Tax Journal 727.

[11] Barkha Jamwal, 'A Study on the Secret World of Tax Havens' International Journal of Applied Research 2017 719.

[12] ibid.

[13] Central Board of Direct Taxes, 'Guiding Principles for Determination of Place of Effective Management (POEM) of a Company'.

[14] 'Income Tax Act, 1961'.

following feature:
1. Rights or obligations, not ordinarily created between persons dealing at arms' length; or
2. Abuse or misuse of the provisions of the Act, whether directly or indirectly; or
3. Lacks commercial substance defined under section 97; or
4. Arrangement carried out in such a manner, not ordinarily employed for *bona fide* purpose [15].

It further states that an arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, for the purpose of obtaining tax benefit.
Tax treaty v GAAR:
Pursuant to clarification given by CBDT - GAAR shall not be invoked if there is a presence of 'Limitation of Benefit' clause in tax treaty;
If assessee is located in a tax efficient jurisdiction, which is been finalised on non-tax commercial considerations and main purpose is not to obtain tax benefits, then also GAAR will not apply [16].

5. Adoption of OECD's BEPS agenda
OECD and G20 countries including India collaborated on a project – OECD BEPS (Base Erosion and Profit Shifting) and has come up with set to combat tax avoidance. CBDT has notified rules on 1st November, 2017, for maintaining and furnishing of transfer pricing documentation in the Master File and Country-by-country report [17]. Section 286 was inserted for furnishing of a 'country-by-country report' in respect of an international group by its constituent or parent entity. Section 92D was also amended to provide for keeping and maintaining 'Master File' by every constituent entity of an international group.

6. Tax treaties with other countries
Government of India has amended few tax treaties with Mauritius, Singapore. The intent of India-Mauritius Protocol is to prevent 'round tripping', a phenomenon by which Indian companies avoid tax by sending funds abroad and then bringing them back to India via Mauritian companies. This protocol has no retrospective effect on existing investments. Thus, shares acquired or loans made on or after 1st April 2017, would attract capital gain tax [18].
Thus, Indian tax landscape has changed significantly for companies having complex business structures by adoption of new laws incorporating OECD/G20 BEPS, issuance of GAAR and taxation on the basis of residence.

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