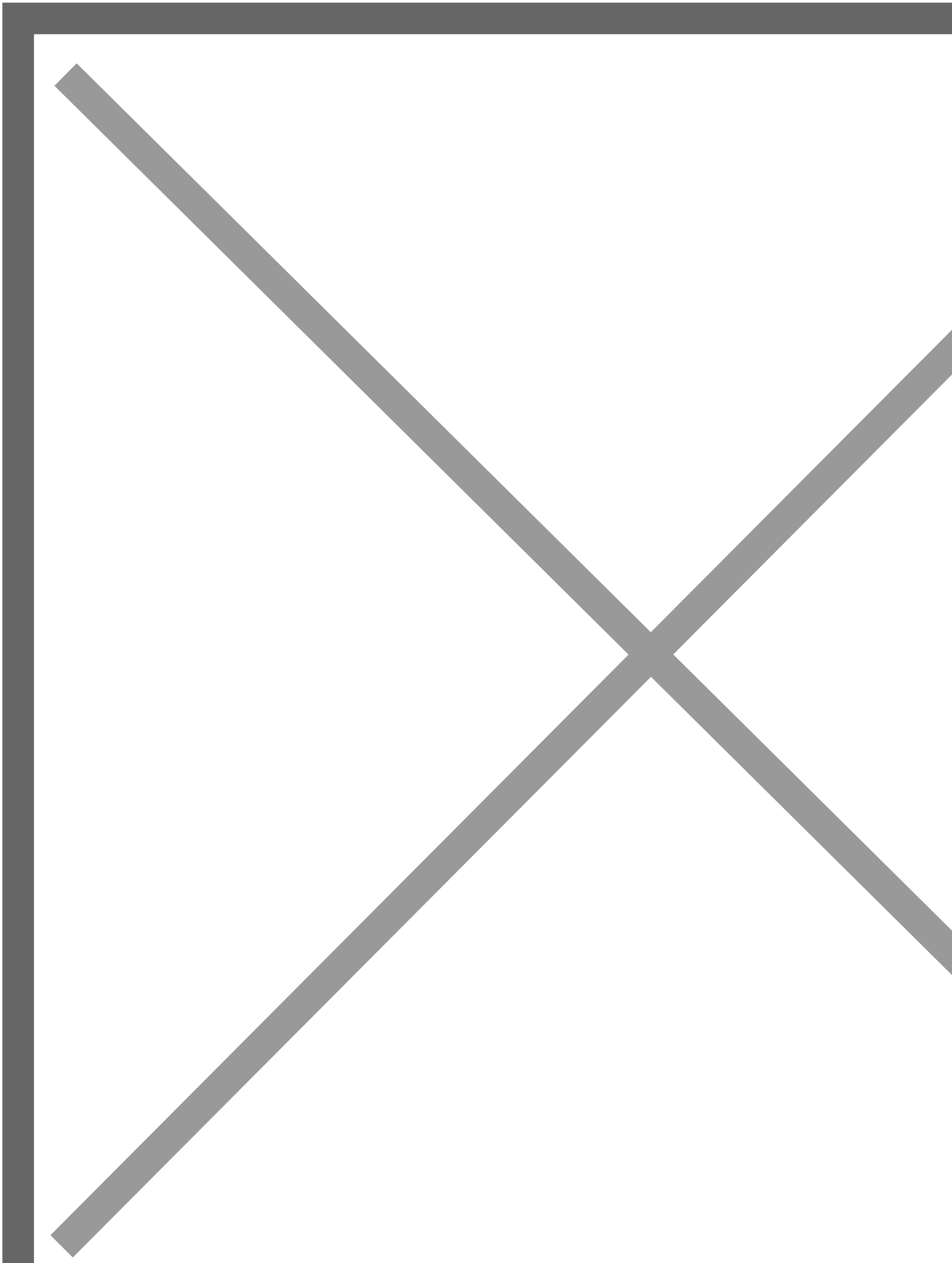
Spiced up exchange

International Tax | Management of taxes



01 September 2015

Kriyang Karia and *Martin Callaghan* consider the implications of the common reporting standard in the UK and India

Key Points

What is the issue?

The automatic exchange of information and specifically the OECD’s Common Reporting Standard, is seen as one of the answers to tax evasion. Both the UK and India are early adopters of the CRS

What does it mean to me?

For the UK and India, the CRS provisions will take effect from 1 January 2016. In September 2017 the first exchanges of information will take place

What can I take away?

It is imperative UK and Indian taxpayers assess whether they can benefit from time-limited voluntary disclosure opportunities while they are available

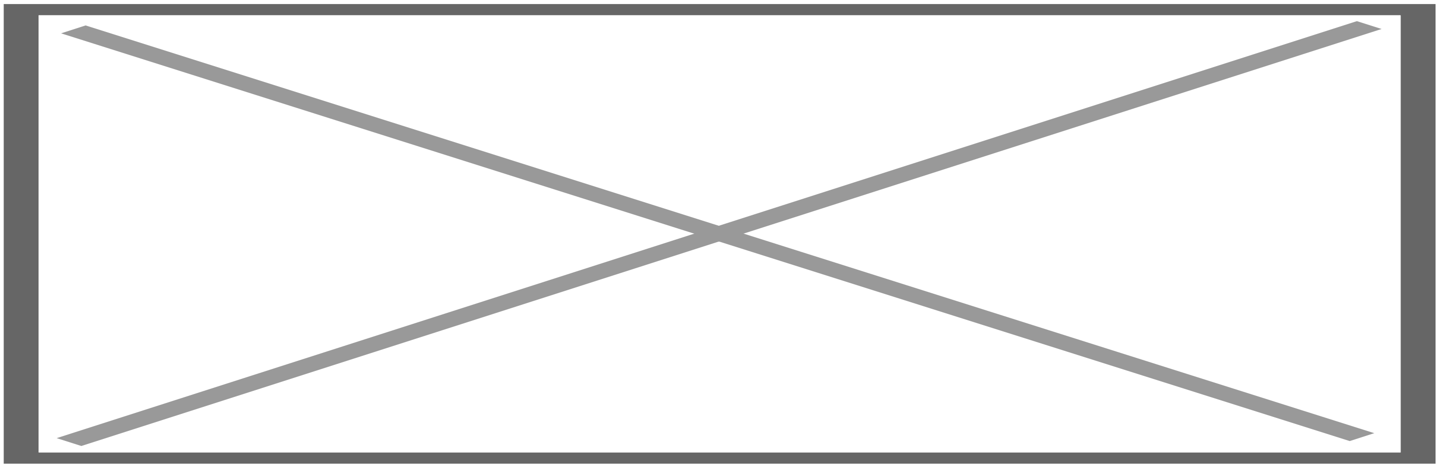
No one knows the true scale of tax evasion. But since the global economic crash in 2008 governments have been increasingly keen to make up lost revenue by locating and reclaiming this pool of untaxed money, aims that are supported by the Organisation for Economic Co-operation and Development (OECD).

Two leaders who have been particularly vocal in tackling tax evasion have been David Cameron and his Indian counterpart, Narendra Modi. The UK tax gap due to tax avoidance and evasion is estimated at £7.5 billion a year. In India, the director of the country’s elite Central Bureau of Investigation said in 2012 that residents had $500 billion (£320 billion) of illegal funds in foreign tax havens.

In common with many jurisdictions around the world, the UK and India increased powers for tax authorities and increased penalties for recalcitrant taxpayers. As a sweetener, they offered time-limited voluntary disclosure regimes.

Of course, these measures would achieve little unless there was a genuine chance that those evading tax would be caught. The automatic exchange of information (AEOI) and specifically the OECD’s Common Reporting Standard (CRS), is seen as the answer. Both the UK and India are early adopters of the CRS.

Image



Tax authorities have had the power to exchange information for many years under double taxation agreements and, more recently, tax information exchange agreements. In general, the limitation of these arrangements is that, unless a tax authority is certain that someone is evading tax, any request for information will fall foul of ‘anti-fishing expedition’ provisions. However, AEOI will change this.

There will be no need for taxation authorities to request information or perceive that someone has undeclared offshore assets. Financial and other information about their residents’ overseas accounts will be transferred automatically to the UK and Indian tax authorities annually.

Using the Foreign Account Tax Compliance Act (FATCA) as a template, the OECD produced a global standard, the CRS, which sets out the basis for AEOI between tax authorities.

For the UK and India, the CRS provisions will take effect from 1 January 2016. In September 2017 the first exchanges of information will take place.

What are the implications of the CRS for financial institutions?

Financial Institutions (FIs) have two main responsibilities under the CRS.

Know your client

FIs must identify ‘reportable accounts’ and as a consequence need to ensure their ‘know your client’ information is up to date and accurate. They must have robust systems in place therefore.

A reportable account is an account of a beneficial owner who is a tax resident in a ‘reportable jurisdiction’. This is one that has adopted the CRS.

The due diligence obligations differ for high-value and low-value accounts; for individuals and entities; and for existing and new accounts.

Reportable information

FIs will have an annual obligation to report financial information on reportable accounts to their local taxation authorities. The authorities will pass that information to their equivalents where the account holder is resident.

What are the implications for their clients?

Under the CRS, the UK and Indian tax authorities will receive unprecedented volumes of information. Clearly, if someone deposited funds in an undeclared overseas account and the details of that account are reported to the UK or Indian tax authorities, it is likely that an investigation will be launched.

Even if a taxpayer believes that they always complied with their taxation obligations, they may be affected by the CRS.

UK perspective

Regardless of whether an overseas financial asset generates taxable income or gains, the holding of it will be reported to the authorities. This is likely to flush out areas of non-compliance, deliberate or not. In the UK, the rules on the taxation of non-UK domiciled individuals are complex and change often. There is huge scope for inadvertent remittances to be made or for ‘clean capital’ to be tainted. There are also many UK anti-avoidance provisions that could apply to offshore structures which historically may not have been considered properly.

These are the areas that HMRC will review and will expect to generate revenue from.

Indian perspective

Alongside the CRS, the Indian revenue authorities created a mechanism to track assets held outside the country and income from any external source.
The Indian tax return form now requires details of:

- foreign bank accounts held (including any beneficial interest);
- financial interests in any entity;
- immovable property or any other capital asset held (including any beneficial interest);
- accounts in which a taxpayer has any signing authority (including any beneficial interest); and
- trusts created under the laws of a country outside India in which the taxpayer is a trustee, beneficiary or settlor.

The Indian revenue authorities will reconcile the information received under CRS with the declarations made on the tax return form. Any mismatch is likely to trigger enquiries.

How will the CRS apply in practice?

Perhaps the best way to explain how the CRS may apply is through the use of three simple, but common, scenarios set out and explained below:

> **Scenario 1**: Mr Smith is UK resident but non-UK domiciled. He has a bank account in the Isle of Man and makes no remittances to the UK. Mr Smith pays the remittance basis charge.
> **Scenario 2**: Mr Patel is resident in India. He has a portfolio account with a Swiss bank.
> **Scenario 3**: Mr Jones is UK resident, but non-UK domiciled and has settled a discretionary trust that is resident in Jersey. His is excluded from benefiting. The class of beneficiaries includes UK resident individuals and India resident beneficiaries. The trust property consists of a professionally managed portfolio within a bank account in Jersey. A trust company provides professional trustees.

Scenario 1

Mr Smith's domicile position is of no relevance. Foreign domiciliaries are treated in the same way as any other UK resident individual.

The bank is a financial intermediary (FI) under the terms of the CRS. As a consequence, it has an obligation to make a report about the reportable account. It will collate and report the following information on Mr Smith to the Isle of Man tax authorities:

- name, address, dates and place of birth, tax identification number;
- account number and account balance;
- gross interest and dividends and other income; and
- gross proceeds from the sale of financial assets.

This information will be exchanged with HMRC and analysed by the offshore co-ordination unit (OCU) using HMRC's Connect IT system. This analysis will form the basis for deciding whether HMRC will investigate a taxpayer's affairs. If there appears to be a mismatch between the taxpayer's lifestyle (eg the house they live in, or the car they drive) and their level of reported income, HMRC may need reassurance that no taxable remittances were made from the offshore account.

Scenario 2

For the purposes of CRS, Mr Patel has a reportable account with a bank in Switzerland. The same type of information on Mr Smith reported by the Isle of Man bank will be reported by the Swiss tax authorities to India about Mr Patel.

This information will be reconciled by the Indian revenue authorities with the information submitted by the tax payer on his tax return. Any mismatch is likely to trigger scrutiny of the taxpayer.

Scenario 3

As a result of the professional management of the trust (and its portfolio), the trust itself is an FI. However, it will be a non-reporting FI as long as the trust company agrees to report on its behalf. It would then become a trustee-documented trust. The trust can self-certify its status to the bank. No reporting would then be required by the bank.

The reportable financial accounts are the equity interests held by the settlor, beneficiaries or any other person who can exercise ultimate control over the trust. For these purposes, a beneficiary who may receive a discretionary distribution from the trust will be treated as a beneficiary only in the calendar year in which they receive a distribution. Regardless of whether the settlor is excluded from benefiting, their 'interest' will be reported.

The reporting FI will report to the Jersey tax authorities, which will pass the following information to the UK and Indian taxation authorities:

- names, addresses, dates and place of birth, tax identification numbers;
- the name and identifying number (if any) of the reporting financial institution;
- the account value, namely the equity interest. The commentary to the CRS describes this as 'the value calculated by the FI for the purpose that requires the most frequent determination of value'; and

- gross amounts credited to each individual.

The Indian tax return forms require disclosure of beneficial interests (including as settlor or a trustee) in an offshore trust. However, it is not clear whether and how beneficial interests in discretionary trusts are reported. Beneficiaries of discretionary trusts are not always aware of their status until such share is distributed to them. The Indian taxpayer will have to report on their return any distribution received and it will be reconciled with the data received through CRS by the Indian authorities.

As can been seen from the above, the CRS will catch those who have complied with their obligations and those who have not. The best policy now is for taxpayers and their advisers to review their financial affairs (such as accounts or interests in offshore structures) to ensure there are no problems. If there are, the best way of dealing with them is a voluntary disclosure to the tax authorities.

How to regularise the past

UK

It was announced in the 2015 Summer Budget that HMRC will compel tax advisers, financial intermediaries and other professionals to notify their clients about:

- the forthcoming exchange of information with other jurisdictions under the CRS; and
- a limited time disclosure facility from early 2016 to enable people to regularise their tax positions before the CRS information starts to arrive.

The new disclosure facility will replace the voluntary Liechtenstein Disclosure Facility (LDF), which closes for most new registrations on 31 December 2015.

The terms of the new one will not be as beneficial as the LDF's. Another difference is that it will not provide immunity from prosecution.

For many people there are significant benefits of using the LDF, including a part amnesty, lower penalties, guaranteed immunity from prosecution and no 'naming and shaming'. So, if a disclosure is necessary, it should be done while it remains available.

Banking and financial secrecy is coming to an end as we enter an era of tax transparency. HMRC's clear aim in compelling advisers to inform their clients about the forthcoming changes is that those with matters to disclose will use the available facilities rather than wait for an investigation.

India

To regularise the past, the taxpayer can use one of the following two options:

- Revision of tax return filed earlier in which foreign assets and foreign income were not disclosed.

Indian tax law permits the revision of tax returns up to two years from the end of the relevant fiscal year. However, returns already under enquiry cannot be amended.

- Declaration under the compliance window of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015 ('The Black Money Act').

Under this, a one-time compliance window has been declared by the Indian government for taxpayers with undeclared foreign assets. A declaration can be made in specified form (Form 6) by a tax resident of India for any undisclosed foreign assets outside India and acquired from income chargeable to tax for any fiscal year before 2015/16.

The declaration can be made for any undisclosed asset outside India for which the taxpayer:

- failed to submit a tax return; or
- failed to disclose such income in a tax return filed before the commencement of the Black Money Act; and
- such income had escaped assessment by reason of the omission or failure on the part of the taxpayer to file a tax return, or to disclose fully and truly all material facts necessary for that assessment.

A taxpayer making a declaration under the compliance window is liable to pay tax of 30% of the value of the undisclosed asset and pay a penalty of 100% of the tax. The window is open from 1 July 2015 to 30 September 2015. Payment of the taxes and penalties must take place by 31 December 2015.

Making a disclosure during the compliance window regularises the income and assets declared. Further, the declaration is not admissible as evidence against the taxpayer in any penalty or prosecution proceedings under the Exchange Control Regulations, Companies Act or the Customs Act. Moreover, this facility to file a declaration, which is billed as a last chance to come clean, can be used quickly and confidentially.

The benefit of the compliance window is not available:

- if notices for audit or scrutiny have already been issued to the taxpayer; or
- if information on undisclosed foreign assets has already been received by the competent authority on or before 30 June 2015 under a double taxation agreement entered into by the Indian government.

The Indian government issued a circular explaining coverage of the compliance window. However, more clarity is required in some areas, including whether investments in pension plans generating income later will need to be reported or whether assets acquired from overseas income, which is exempt from tax, need to be disclosed.

Conclusion

Although there are no official numbers about the possible inflow of revenue under the disclosure opportunities in India, the primary motive is the same as the UK disclosure programmes, namely to deter future tax evasion.

In both jurisdictions, it is imperative for taxpayers to assess whether they can avail themselves of these time-limited opportunities while they are available. The penalties for non-compliance are increasing, as is the likelihood of undeclared assets being discovered.