FOCUS ON H.N.W.I.'S AND OFFSHORE STRUCTURES – AN INDIAN PERSPECTIVE

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INTRODUCTION

The topic of offshore assets held by high-net-worth individuals ("H.N.W.I.'s") based in India is a topic of substantial interest for various governmental authorities in India. It is not just the Indian Tax Authority that is interested in offshore accounts. Substantial exchange control regulations are in place in India and other regulatory authorities keep a close track of the offshore interests of Indian residents.

Over the years, Indian names appeared in data leaks of offshore structures and bank accounts, triggering significant administrative focus and amendments to the law. In 2015, the Black Money Act[1] was introduced in India, with the stated intent of enacting provisions to deal with the problem of undisclosed foreign income and assets and to impose tax on undisclosed foreign income and assets.

DATA LEAKS

Information leaks and action on that account by the regulators have been the focus of global political campaigns for several years. There have been multiple data leaks, of which the most prominent are the Swiss Bank data leaks, Portcullis leaks, Panama Papers leaks, and the Paradise Papers leaks, which invited the attention of the legislators and regulatory authorities in various parts of the world. In India, these leaks created huge political interest, so much so, that recovering black money stashed abroad was one of the most prominent agenda on the Bhartiya Janta Party's manifesto[2] during its successful 2014 election campaign.

In comparison to the general perception regarding leaked names, not all named individuals and entities appearing in these leaks are tainted. It is possible that the leaked structures are fully compliant with the regulatory framework in India that is applicable for setting up external holding companies and business related structures.

INDIA'S REACTION

Several legislative and administrative changes were introduced in Indian tax laws as a direct result of the data leaks.

- In 2011, the Supreme Court of India directed the creation of a special investigation team to monitor the offshore assets investigations undertaken by various authorities.

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[1] The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

[2] The Bhartiya Janta Party is the ruling party in India.

- In 2012, significant reporting requirements were introduced in Indian income tax forms, specifically requiring submission of data concerning offshore assets and interests held by resident Indians.
- Also in 2012, the legislature increased the maximum look-back period for imposing tax on undeclared income from six years to sixteen years for cases involving offshore assets.
- Various measures were taken to strengthen income tax treaty provisions dealing with exchange of information with various jurisdictions, most prominently Switzerland. In addition, a number of Tax Information Exchange Agreements ("T.I.E.A.'s") were entered into to obtain information relevant to taxation of Indian residents and companies owned abroad.
- •In 2015, the Black Money Act was introduced to specifically deal with the issue of money stashed abroad. The Black Money Act provides for the imposition of a 30% tax and a penalty of 90% on the amount of undisclosed income and assets discovered by the tax authorities. Prior to the introduction of the Black Money Act, the law provided for a one-time opportunity for eligible declarants to (i) make a voluntary disclosure, (ii) pay a 30% tax and a 30% penalty on undisclosed offshore incomes and assets, and (iii) obtain immunity from the application of various Indian laws that would otherwise punish an Indian resident holding hidden accounts abroad.

UTILIZATION OF LEAKED DATA

Investigations were initiated, notices issued, and searches conducted on the premises of entities and individuals named in the data leaks, all with the purported goal of gathering information for purposes of confrontation with the named party. Information requests were made to the authorities of various jurisdictions, such as Switzerland, Singapore, and the British Virgin Islands. Ultimately, adverse orders were issued against individuals named in such leaked data.

In the case of the Swiss Bank data leaks, the Indian authorities received certain summaries referred by them as "base notes." Typically, the base notes provided the name of the individual, basic identification data, names of related entities or trusts linked to the individual, peak balances held in bank or investment accounts, and information concerning assets and investments held in such structures. Based on the information received, the Indian authorities issued tax assessment orders and penalty orders against named individuals.

In many cases, the peak balances mentioned in the base notes related to bank accounts held by a holding company that was owned by a trust having multiple beneficiaries. Indian tax authorities simply disregarded the structures and possible beneficiaries and treated the peak balances as belonging to the Indian resident named in the base notes. The path chosen by the Indian authorities seemed to be inconsistent with settled case law.

The leading case regarding the taxation of discretionary beneficiaries of trusts is *CWT v Estate of Late HMM Vikram Sinhji of Gondal*, [2015] 5 SCC 666, 672. There, the Indian Supreme Court, which is the highest court of law in India, observed that the mere status of a person as a beneficiary in a discretionary trust does not mean that the income of the trust belongs to that discretionary beneficiary when and as

realized by the trust. Rather, a beneficiary has only a hope of receiving a distribution until such time as the trustee exercises discretion to make a distribution to that beneficiary.

It is normal for H.N.W.I.'s in India to set up trusts for wealth planning, asset protection, and inheritance purposes. Similarly, it is not uncommon for an H.N.W.I that is of Indian origin but is resident in an offshore jurisdiction to settle an offshore trust in a third jurisdiction for the benefit of his family members and relatives. The class of beneficiaries may include one or more Indian residents. As part of the onboarding process followed by the financial institutions and service providers, the names of all beneficiaries of the trust will wind up in the K.Y.C. records of the financial institution holding the assets of the trust. Even though no current benefit may have been realized by an Indian discretionary beneficiary, the beneficiary's name may appear in the base note. In many instances, the Indian resident individual does not know that he or she is a discretionary beneficiary.

Nonetheless, the unwavering position of the Indian tax authorities is to adopt a "look through" approach and to impose tax and penalties on all Indian residents named in the base notes. It is believed that hundreds of requests for information have been made to Switzerland by the Indian tax authorities as a result of the base notes. Much litigation has taken place to challenge the actions of the Indian tax authorities. More is expected in the future.

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INFORMATION EXCHANGE

When the tax authorities in India made their initial requests to tax authorities in Switzerland in accordance with Article 26 (Exchange of Information) of the India-Switzerland Income Tax Treaty, the Swiss authorities denied the requests. The basis for denial was grounded on public policy, a legitimate exception in the treaty. Stolen data could not be exchanged because it arose from stolen property. This is often referred to as "fruit of a poisonous tree."

That position was reversed in 2018, when the Swiss Federal Court adopted a narrow approach to the poisonous tree doctrine. It ruled that while the information was stolen, the theft was made by an independent actor, not the tax authorities, and the information was gratuitously transferred to the Indian tax authorities by tax authorities of another country. As India did not steal the documents, its hands were clean. Accordingly, information could be exchanged.

Based on that view, hundreds of previously denied information requests were revived and information exchanges took place. From 2019 onwards, various decisions have been rendered by Swiss courts allowing sharing of banking and other financial information sought by India.

While Swiss local laws provide stakeholders with a mechanism to challenge exchanges of information, challenges by stakeholders is not the norm in many other countries. When a request for information is received, a prompt sharing is made. Information is shared without any opportunity to challenge the exchange by the requisite stakeholders.

STAKEHOLDER CHALLENGES

Several concepts are universally enshrined in exchange of information articles of income tax treaties and T.I.E.A.'s.:

- The requested information must have foreseeable relevance to a tax obligation in the requesting country. Treaties and T.I.E.A.'s cannot be used as part of a fishing expedition.
- The request for information must be made in good faith.
- The exchange of information must not violate public policy in the country receiving the request. Requests should be denied if they (i) relate to secretive local laws, (ii) are made with the intent to further political vendetta, or (iii) will allow for the retroactive application of criminal sanctions against the taxpayers.
- The requesting country must have in place adequate data protection laws.
- The requesting country must have end-user restrictions so that the shared information should be used principally the proper administration of tax laws.

These concepts have been dealt with at length in a number of court rulings concerning requests made by the Indian tax authorities to counterparts in Switzerland, the U.S., and Singapore. Challenges to contemplated exchanges generally have been unsuccessful. Courts reason that arguments such as those listed above are more properly made before judicial panels of the country making the request. Stated somewhat differently, courts shy away from having to rule on the good faith of a treaty partner jurisdiction.

SHARED DATA

Broad contours of data sharing generally appear in the exchange of information provisions in income tax treaties, the operative provisions of T.I.E.A.'s, and multilateral agreements. Information requests tend to relate to the following items:

- Information regarding bank accounts, including account balances, bank statements, bank advice, and the identity of account holders
- K.Y.C. documents and account opening forms. This may also include company incorporation documents, trust deeds, and similar documents that were collected by financial institutions and corporate service providers at the time of onboarding
- Beneficial ownership details of bank accounts, investments, and properties
- Portfolio statements
- Internal email correspondence, communications with the bank, meeting notes and client instructions recorded by bank employees

AVENUES FOR INFORMATION GATHERING

E.O.I on Request

A country may make an exchange of information request under the relevant treaty or agreement for the purposes of implementation of the tax treaty or for administration or enforcement of domestic tax laws.

Income Tax Treaties

Income tax treaties are bilateral agreements that focus on sharing taxation rights between participating countries. In very broad terms, taxing rights and administrative obligations are undertaken by both treaty partner countries. The tax authority in each country is entitled to seek information regarding its residents from the tax authority of the other country. In turn the tax authority in the other country is obligated to obtain the sought after information and to forward it the tax authority making the request.

Tax Information Exchange Agreements

In comparison to income tax treaties, T.I.E.A.'s refer to agreements under which each partner country undertakes to provide information to the other country regarding the residents of the other jurisdiction. Certain information is provided spontaneously, other information is provided on request.

Multilateral Convention on Mutual Administrative Assistance in Tax Matters

The Convention provides for administrative cooperation between signatory countries in the assessment and collection of taxes. Cooperation ranges from automatic exchanges of information, to exchanges on request, and finally to the recovery of foreign tax claims.

Mutual Legal Assistance Treaties ("M.L.A.T.")

M.L.A.T.'s enable law enforcement authorities and prosecutors to obtain evidence, information, and testimony abroad in a form that is admissible in the courts of the requesting state.

Common Reporting Standards ("C.R.S.")

The C.R.S. is a global standard for the automatic exchange of financial account information between governments to combat cross-border tax evasion. India has adopted the C.R.S. and has signed up to share financial information with other countries. Under C.R.S., there is a systematic and periodic collection and transmission of bulk taxpayer information by the source country to the country of residence of the taxpayer, without the latter having to make a request for the same.

PATH FORWARD FOR H.N.W.I.'S IN INDIA

There is a continuous uptick in modes and procedures of cooperation among nations regarding exchanges of information and assistance in recovering taxes. This

trend has enabled Indian law enforcement agencies administering exchange control and anti-money laundering laws to provisionally attach offshore bank accounts and assets linked to residents of India.

Indian H.N.W.I.'s owning offshore assets must be careful when it comes to reporting foreign income and assets in Indian tax filings and in filings before the exchange control authorities of the Reserve Bank of India. In spite of the fast globalization of the Indian economy, offshore assets, trusts settled under foreign law, and related structures formed under foreign law continue to be perceived negatively by administrative authorities. Hence, caution is imperative when responding to official questions and follow-up inquiries. Compliance deficiencies may result in heavy penalties and criminal sanctions under Indian tax law and the Black Money law.

Robust documentation in support of all offshore transactions must be maintained and provided to Indian authorities upon request. Professional support to oversee compliance throughout the year is extremely helpful when it comes to dealing with offshore interests.

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H.N.W.I.'s should also maintain proper documents in support of their residential status. These include passport copies with in-and-out travel stamps where available, visa copies, Tax Residency Certificates ("T.R.C.") for periods of stay outside of India. It may be difficult to obtain past copies of T.R.C.'s after a certain amount of time passes. Hence, one may consider to apply regularly for T.R.C.'s and to keep them handy for future submissions. Also helpful are copies of accommodation receipts, rent agreements, and utility bills in order to prove residential status if required. Also helpful is the use of geographical tracking applications on mobile devices, allowing an individual to demonstrate his or her location for every day during the year simply by walking around with the device.

Notices and questionnaires received from a regulatory agency or a law enforcement authority should be taken seriously, reviewed by competent counsel, and then responded to promptly. Indian tax returns require robust information concerning offshore assets and should be taken seriously.

H.N.W.I.'s relocating to India or moving out of India should seek professional advice from local advisers prior to the transfer of assets and investments to entities formed outside of India.

CONCLUSION

While Indian H.N.W.I.'s are expanding their businesses, activities and footprint on a global basis, they need to keep abreast of the changing laws and regulatory framework in tax and exchange control laws.

Maintaining robust documentation and ensuring accurate and complete disclosure in all statutory filings in India are key to avoid litigation or criminal prosecution stemming from the failure to file a complete report.

Comparable attention to documentation is important for expats moving into India as their global assets, investments, and income will be reportable in India once they become tax residents of India.

The following key aspects apply to expats moving to India:

- Maintain day count in and out of India; apps are available for tracking days automatically on a mobile device.
- Redesignate nonresident ordinary and nonresident external accounts to Indian Rupee and savings accounts.
- All leveraged and sophisticated financial instruments owned prior to arrival which may be problematic from an exchange control viewpoint should be identified; regulatory approvals will be required under Indian exchange control regulations once an expat becomes a resident of India and planning is required prior to immigration.
- Foreign directorships and operational control over offshore entities from India should be discouraged, as each may have adverse tax implications in India for the offshore entity.
- Careful fiscal planning on wealth retained abroad should precede arrival in India.