CHAPTER 3

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CHAPTER 3

Controls on remittances

Chapter Overview

A remitter is required to submit an undertaking that he has abided by the FEMA requirements. He is also required to submit a certificate by a chartered accountant certifying the undertaking. The certificate and undertaking (C&U) form the basic documents that the AD must examine before the remittance. The rigours of checks expected from the ADs on each individual remittance are rendered unviable with the increase in the volume of remittances.

A copy of the C&U on every remittance is sent by the ADs to the assessing officers (AOs) in the ITD. The manual receipt and collation of C&Us in ITD are in a disarray especially in heavy assessment charges. Stacks of C&Us lay dumped in rooms making their retrievability, a near impossibility. No reconciliation of C&Us is possible between ADs and ITD in this scenario. Our assessment of the tax gap on the remittances in the audit sample was severely constricted given the state of record management of C&Us in ITD. Even so, we found that ₹ 98.7 crore was not deducted during the period 2005-09.

ITD introduced e-filing of undertakings but it meets the purpose only partially as it is yet to be harmonized with the returns to RBI or even integrated with the e-filed quarterly TDS returns. The TDS returns are also not being processed in ITD. The weak controls across the government leave wide gaps for tax evasion.

3.1 The ADs play a pivotal role in providing an assurance on the conformity of forex remittances to sovereign Acts. We examined the ability of the ADs to discharge their functions with reference to the volume of transactions and the nature of the responsibilities placed on them.

3.2 Data on the total volume of forex transactions handled by ADs was not available. On an average, each AD remits around ₹ 700 crore every year. The number of checks and the nature of checks make the process cumbersome. With the introduction of FEMA, RBI decided not to prescribe the documents which should be verified by the ADs. Instead it was left to the ADs to satisfy themselves on the nature and purpose of the remittance. However, the guidelines prescribing onerous checks by the ADs continue and a viable alternative is yet to emerge.

The checks prescribed by RBI in respect of remittances relating to foreign shipping companies or their agents in India, illustrate the rigours expected of ADs. The ADs are required to check that collection of freight is duly supported by details (contained in the 'freight manifest') of the cargo carried, the port of embarking and of discharge. They are also required to check in detail the entries in respect of 10 to

15 *per cent* of the freight manifest and to cross reference the same with the export tally sheet certified by the surveyors of the shipping companies towards actual loading. The bills of lading (document given by the carrier to the shipper acknowledging that specified goods have been received on board) in respect of imports are to be verified. In respect of receipts other than freight, suitable documentary evidence is to be verified in detail. ADs are required to watch the voyage-wise details from foreign shipping companies/agents for crediting freight/ passage collections.

Similarly, remittances towards refunds of Income tax are required to be preceded by cumbersome checks by the ADs: they are required not only to verify the original assessment order, the source of funds of investments, profits arising thereof, income tax returns etc. ₹ 544 crore[30] was remitted towards refunds during 2007-08 to 66 countries; in 2008-09, the figure was ₹ 1988 crore[31] remitted to 73 countries.

3.3 Innovative solutions are required that meet the need for control without making the controls cumbersome and ineffective. We are of the opinion that the rigours of checks at the level of the AD impinge on the effectiveness of such controls, which makes the need for co-ordination with the ITD even greater. We also feel that ITD is a key partner in the framework of governmental oversight and its performance would need to be assessed not only in its ability to collect tax but also its role as a deterrent in money laundering.

Collection and transfer of documents

3.4 A remitter is required to submit an undertaking that he has abided by the FEMA requirements. He is also required to submit a certificate by a chartered accountant certifying the undertaking. The ADs send a copy of the certificate and undertaking (C&U) *on each individual remittance* to the assessing officer (AO) in ITD. We approached about 1688[32] ADs in order to correlate the receipt and transfer of C&Us to the ITD. 253 responded to our queries, of which 129 ADs reported nil remittances during the period under review. Our findings on the remaining 124 ADs are illustrated below:

A Collection of C&Us

The process does not provide an assurance that C&Us with respect to each remittance are collected by the ADs from the remitter. For instance, we found that during 2004-06, there has been import of merchandise to the extent of ₹ 40445 crore. However, the ADs did not collect C&Us for remittances made for the above import of merchandise[33].

[30] Includes remittances of ₹ 32.03 crore to unspecified countries and remittances of ₹ 1.62 crore to 15 countries with whom India does not have DTAA

[31] Includes remittances of ₹ 1258.84 crore to unspecified countries and remittances of ₹ 20.76 crore to 21 countries with whom India does not have DTAA

[32] 115 under category A and 1573 under category B

[33] RBI/A. P. (DIR Series) Circular No. 03 dated 19.07.2007 specifies that C & Us are to be submitted even in respect of import of goods.

B Completeness of C&Us

We found instances where the C&Us did not mention vital data on remittances. For instance in Karnataka, C&Us supporting seven remittances aggregating to ₹ 13.5 crore made through three ADs during 2005-08, did not mention the purpose and no tax was deducted from the remittances.

Capital gains tax is not deductible on a remittance relating to sale of shares if Securities Transactions Tax (STT) has already been levied. We found that tax was not deducted from 13 remittances worth ₹ 9.8 crore in 2006-08 in Andhra Pradesh, CIT Hyderabad although the C&Us were not supported with the details of transaction such as date of acquisition of share, sale and demat account. These details were required towards verifying the admissibility of the exemption of capital gains tax.

C Transfer of C&U to ITD

Our study across 16 branches of ADs showed that they had not forwarded C&Us in respect of 16305 transactions involving a remittance of ₹ 5613 crore to the ITD. We correlated the receipt of C&Us in ITD in detail in two States. We found that the *ITD was not receiving C&Us from 73 per cent of the ADs in Tamil Nadu; the figure was 75 per cent in Karnataka.* In Madhya Pradesh, the assessment records of 31 assessees showed foreign remittances, but the ITD could not produce the C&Us supporting the remittances. The liaison of ITD with ADs was clearly deficient and the gap remains to be effectively bridged even after we raised the issue with ITD.

Calyon Bank, Tamil Nadu, made 22 remittances of ₹ 3.5 crore relating to Saint Gobain Glass and Air Liquid Engineering Pvt Ltd during 2004-06 towards 'fees for technical services', on which tax amounting to ₹ 44.2 lakh was leviable. However, the AD did not transfer the C&Us and did not deduct the TDS either.

D Transfer of C&Us to unrelated AOs

We found 72 C&Us relating to remittance of ₹ 18.2 crore in 3 States[34] which were forwarded to officers other than the AO where the remitters were assessed.

E Deduction of tax on remittances

We attempted to cross-check a sample of C&Us received in ITD for the tax deductibility of remittances. This was no mean task given the state of record management of C&Us in ITD (refer paragraph 3.10). In all, we found that TDS of ₹ 44.7 crore was not deducted from remittances made during the period 2005-09 in 4 States[35]. In addition, ₹ 2.9 crore was deducted less than the TDS leviable in 3 States[36]. Income Tax Act disallows deduction of those items of expenditure on which

[34] Delhi, Tamil Nadu, West Bengal
[35] Andhra Pradesh, Delhi, Karnataka, Tamil Nadu
[36] Karnataka, Mumbai , Tamil Nadu

tax had not been deducted. We found 8 cases where remittances amounting to ₹ 114.4 crore were disallowed by the AOs; the TDS that was not collected on these remittances amounted to ₹ 42.4 crore. The process is unable to provide an assurance that the ADs collect the TDS at the time of remittance.

Charge: DIT (IT), Chennai, Tamilnadu; AY: 2003-04 to 2005-06
Assessee: Cairn Energy India Pvt Ltd

The assessee made remittances towards acquiring and processing of seismic data/geological data and charter hire charges. As these payments partake the character of royalty and fees for technical services, tax ought to have been deducted. Failure resulted in short levy of tax of ₹ 21.1 crore. The proportionate disallowance under Section 40(a)(i) worked out to be ₹ 90.4 crore involving a short levy of ₹ 37.7 crore.

Charge: DIT (IT), Mumbai, Maharashtra; AY: 2005-06
Assessee: Citi Bank NA.

TDS was not collected on interest of ₹ 47.2 crore paid by the assessee to the head office/foreign branches. The payment was therefore disallowed by ITD and was brought to tax. However, it was taxed at the rate of 10 *per cent* instead of normal rate of tax at the rate of 40 *per cent* with surcharge and education cess. This resulted in short levy of tax of ₹ 26.9 crore including interest. The department accepted (February 2009) our findings and rectified the assessment in May 2009.

F Misclassification of remittances

We found that ₹ 78.74 crore and ₹ 71.35 crore remitted through one AD[37] during the years 2007-08 and 2008-09 had been incorrectly classified under the purpose code for Miscellaneous Remittances(S1019) as against the correct head relating to payment for shipping freight for import and export.

3.5 We are also concerned about forex transactions which are not covered under the requirement of C&U. For instance Income Tax Act[38] exempts income from export of goods or computer software subject to certain conditions, one of which is repatriation of sale proceeds into India in convertible foreign exchange. The sale proceeds shall be deemed to be received in India if they are credited to a separate account maintained for the purpose with any bank outside India with the approval of RBI. Whenever payments are made from this account, there would be no undertaking or certificate as applicable to remittances from India. Thus the veracity and taxability of the transaction would not be available for verification in India.

Controls in tax administration

3.6 The C&Us are received by the AO in charge of the tax assessment of the remitter (deductor who deducts the tax from the payments made to the non-resident) or with the DIT (IT), wherever located. The AO is required to check from

[37] State Bank of India, SP Commercial Branch Indore
[38] Section 10A/10B

the C&U that TDS was deducted as required; if not, the payment (remittance) may be disallowed as deduction during assessment. The remitter is also required to file a quarterly tax return (Form No 27Q) with the jurisdictional TDS Officer. The AO (TDS) is required to co-relate the TDS return (reporting the transactions on which TDS was deducted) with the actual TDS deposited and the interest payable, if any, for delay in such tax deposit.

3.7 The remittances under the invisible account have increased three-fold during 2002-2008. As every remittance is to be backed by a C&U, the quantum of C&Us being received by the Department is gargantuan. The volume has rendered micro check of individual remittances in ITD very difficult. The manual receipt and collation of C&Us was in disarray and we found that stacks of C&Us lay dumped in rooms, with their retrievability a near impossible task, especially in heavy assessment charges. In such a scenario, a system of periodic reconciliation of receipt of C&Us in ITD with those sent by ADs was rendered difficult.

3.8 The tax administration is currently stretched, ill-equipped to handle the flow of records (C&Us) manual or automated. The risks are neither identified nor are they placed on a hierarchy to enable the authorities to be able to either sift risky transactions or mitigate the risks that flow from them.

Correlation with authorized dealers

3.9 We approached the ADs to cross-link the C&Us collected by them with the remittances reflected in assessment records of the remitters. Our findings illustrate the risks that crept into the system in absence of co-ordination between ADs and ITD, as well as due to inadequate monitoring of the C&Us in ITD. Such correlation will not only throw up inadmissible deductions but also put the spotlight on "hidden" remittances.

Charge: CIT, Kochi, AY 2005-06; Assessee: Kochi Shipyard Ltd

The assessee reported an expenditure of ₹ 57.1 crore, which was remitted abroad. The C&Us collected by the AD also showed that the money had been remitted abroad.

We found that the assessee had paid the sum as fees for technical services, on which tax was not deducted at source. When queried, the Department stated that of the total, ₹ 12.5 crore was accounted twice and actual payment was ₹ 44.57 crore only. The balance of ₹ 12.5 crore actually remitted by the assessee through the AD was

unexplained[39] and would have remained undetected but for the correlation attempted by us. This unexplained income involved a short levy of ₹ 4.6 crore.

We found three other instances (of private companies) where the assessees declared (in the tax returns) remittances short of the actual remittance as reflected in the C&Us collected by the ADs. This unexplained income involved a short levy of ₹ 2.7 crore.

Use of C&Us in regular assessment: Analysis of top remitters

3.10 As mentioned in previous paragraphs, even though the AOs fail to get all the C&Us, they need to correlate the C&Us at the time of assessment because remittances (i.e., expenditure) on which TDS has not been deducted is disallowable as deduction and should be brought to tax. The data contained in an undertaking is largely the same as in the certificate and need for two documents is not clear. Given the large volume of certificates, the ITD is currently unable to link the certificates to each remittance, leave alone identify those CAs who have erred or initiate concerted action against them.

3.11 We collected data from CMIE[40], which lends itself to segregation of forex remittances across four categories *viz.,* interest, royalties, fees for technical services and others to identify top remitters whose remittances were liable for taxation. The assessment records of these remitters were used as a base to determine whether the remittances reflected in their tax returns, were supported by C&Us received in the ITD. Given the poor record management of C&Us, this exercise could be conducted only in select charges.

3.12 The assessment charges in Karnataka and Mumbai reported a high level of processing the C&Us received from ADs. But when we asked for C&Us in support of expenditure claimed by the remitters and allowed by the AOs in regular assessment, we were told that the C&Us were not available with either the AO or the DIT (IT). We could not link the C&Us with the assessments in other charges also because they could not be retrieved. Clearly, the ITD is not equipped to cross-link the TDS deductions on remittances with the C&Us; the processing of e-TDS returns is in difficulty (paragraph 3.16-3.18); the AOs are permitting expenditure incurred in forex without assuring themselves that the tax obligations have indeed been discharged.

Charge: DIT (IT), Chennai AY: 2003-04 & 2005-06
Assessee: Shri Narain Karthikeyan
The assessee, a sports person, remitted training fees of ₹ 2.8 crore and ₹ 10.1 crore to non-residents without making TDS. But the remittance was not disallowed as expenditure.

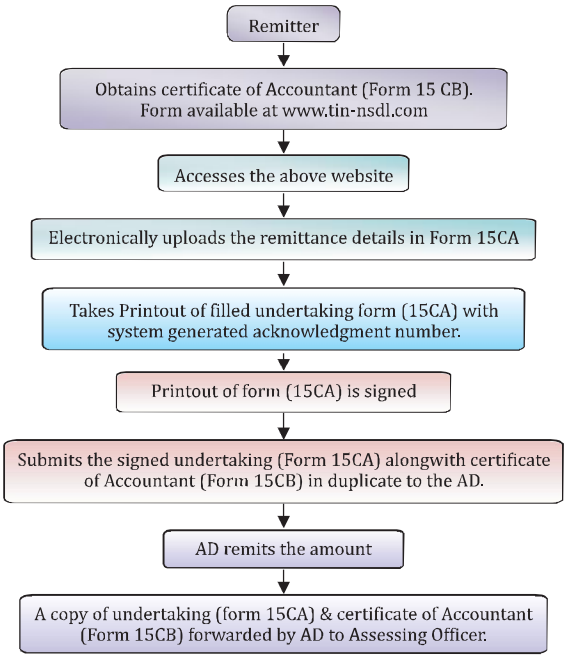
[39] Section 69 of the Act provides that where any expenditure is not explained by the assessee, such amounts may be brought to tax
[40] Centre for Monitoring Indian Economy

3.13 The documentation sought by ITD is two fold: an undertaking from remitter and a certificate from a CA for every transaction. The certificate from a CA is essentially a substitute to the earlier requirement of a no-objection certificate[41]. The requirement adds to the cost of compliance of the remitter as also to the bulk of documents without seeming to serve any effective purpose.

Electronic filing of undertakings

3.14 The process of submission of C&Us has been partly automated since July 2009[42]. The new process (summarized in Chart 5) provides for electronic uploading of the undertaking by the remitter on the ITD's server. The ADs will remit the moneys only on submission of the system generated undertaking. However, the ADs will continue to manually send a copy of the C&Us to the ITD. In our opinion, this step towards automation can help in tracing a particular remittance as also in correlation of remittances with TDS returns. However, a few gaps in the process limit the correlation. Exception reports on the tax rates or quantum of tax that was to be deducted can be generated from a database of undertakings only if the undertaking captures the purpose of remittance (each purpose attracting different rates of taxation) and on whether the remittance is covered under DTAAs. The purpose (of remittance) is not captured under alphanumeric codes in the undertaking. Synchronizing this field with the RBI allotted purpose codes could facilitate such correlation. In addition, the linkages designed to integrate the electronically filed undertaking with the e- filed TDS returns, currently not defined, must be established.

Chart 5: Flow chart of filing undertaking form u/s 195 of IT Act 1961



3.15 We found that the departmental formations in Assam, Punjab, UT Chandigarh and Chennai were unable to access the undertakings which had been electronically filed by the remitters and there was no mechanism for the department to process the same. In Gujarat there were no access issues but they were not being used.

[41] Previously, the remitter was required to obtain the ITCC (Income Tax Clearance Certificate) for each and every forex remittance, which was even more cumbersome. The requirement of C&U was a step towards voluntary compliance by the remitters.
[42] Circular No. 4 of 2009, dated 29.06.2009

Processing of TDS returns

3.16 Though there is no specific time period for processing and assessment of the TDS returns filed, it has been judicially held[43] that action is to be initiated by the competent authority under the Act within a period of four years.

3.17 We found that several field formations[44] in ITD are unable to process the e-filed TDS returns mainly because of problems in online matching of the tax deposit (after the TDS deduction) with the PAN of the remitter. There were also problems of access to AOs in newly created posts. For instance in Kerala access to the TDS returns was given only to officers under regular assessment charges whereas jurisdiction of non-residents had been transferred to the newly created DIT (IT) office.

3.18 e-TDS application is designed to verify the fulfillment of conditions prescribed in the direct tax laws, and throw up mismatch reports where the data filed by the deductors is incomplete or incorrect to enable department to initiate further action. We found that all the parameters necessary for processing of e-returns involving application of DTAA provisions, are yet to be made functional. The Department replied (June 2009) that owing to the complexities of DTAA provisions, it has not been possible to build in all the parameters in the existing e-TDS software.

Streamlining the process: Issues and solutions

3.19 Our assessment on the controls on taxation of forex remittances is that it is currently weak. The burden placed on the ADs would become more difficult with the increasing volume of transactions. It is evident from Chart 2 that the transactions are increasing at a substantial rate. The controls in ITD are unviable too as the C&Us are too voluminous to be correlated to detect tax evasion. The huge tax gap (discussed in paragraph 2.6) further vindicates this assessment. The Committee on Procedures and Performance Audit on Public Services (CPPAPS) constituted by the Ministry of Finance[45] also concluded (2007) that the provisions for TDS are "very onerous and are met only in the breach". Add to this the issues thrown up in the DTAAs and judicial decisions; taxability of an international transaction is a virtual conundrum to be solved.

3.20 The amount of tax gap is too huge to be ignored and calls for an assessment of the contributing factors. The IT Act and the DTAAs together provide for various exemptions to incomes arising to non-residents which are currently, un-quantified in terms of revenue foregone. In an earlier study, we had pointed out the need for a re-look on the exemptions. The Working Group for 'Study of Non-Resident Taxation' had in its report[46] also recommended deletion of various exemptions being extended to non- residents. As incomes exempt arising to non-residents in India would be liable for

[43] CIT Vs NHK Japan Broadcasting Corporation [2008] 305 ITR 137(Delhi)
[44] Andhra Pradesh, Assam, Chandigarh, Delhi, Karnataka, Kerala, Madhya Pradesh, Punjab, Rajasthan and Tamil Nadu
[45] Report No 1 for Examining Exchange Control relating to individuals
[46] Submitted in 2003

tax in the host country/country of residence of the recipient, these exemptions would not affect the recipient but mainly benefit the host country. And India has DTAAs with all the major investing countries.

3.21 We compared the tax rates in different countries to assess whether the tax differential is leading to greater tendency among foreign investors to escape taxation in India and opt for it in their resident country. The corporate tax rates in countries range from 20 to 30 *per cent* (of their net business income). The TDS rates in India of 10-20 *per cent* (on gross receipts) would be much higher than the tax rates in resident countries.

3.22 We feel that a lower flat rate of tax applicable across streams of incomes irrespective of destinations would be workable alternative. This would be easier to implement on the part of ADs as well as the ITD. It would facilitate greater taxpayer compliance, reduce cost of doing business in India and also reduce disputes. This lower rate if incorporated in the Direct Tax Code (DTC), would thus override all other rates provided in the DTAA and would not require re-negotiations with other countries.

Recommendations

- *We are of the opinion that a flat and lower tax rate applied to all payments regardless of their purpose or destination, will be a more viable alternative to administer- for the ITD as well as the banking sector;*

  The CBDT stated that under the existing provisions of domestic law and DTAAs the income liable to tax and the rate of tax varies from case to case. The decision of withholding flat and lower rate of tax to all the payments cannot be taken up unilaterally as most of withholding tax is governed by DTAAs. It was further emphasized that there is a limit to simplification of the statutes and oversimplification in the direction of taxation on gross basis would not be feasible in the domestic context and would not be appreciated in the international context.

  We are of the opinion that CBDT may simplify and rationalize the procedures to the extent possible so that they are easily understandable and implementable. As non residents can opt for the domestic law (Income Tax Act, 1961 or DTC, 2010) or DTAA which ever is beneficial, a clause in DTC would in no way need renegotiation of DTAAs with other countries.

- *Since processing each C&U is not feasible, an automated solution that sifts out error reports from e-filed undertakings is recommended. This would require that the purpose codes of RBI are adopted by the ITD and integrated into the automation. We are of the opinion that this will also facilitate reconciliation of data with RBI;*

The CBDT stated that the suggestion requires further analysis considering the practicability of harmonizing purpose codes of RBI with DTAAs and tax rates contained therein. Electronic filing of C&Us has been introduced only during the last year. Feedback from all stakeholders would be obtained before streamlining the process.

We are of the opinion that the automated system may be made more robust so as to enable field based exception reporting instead of limiting itself to being a view based database of C&Us.

- *The e-TDS returns must also provide data on all remittances, even those with null value for TDS and must also capture the purpose codes;*

The CBDT stated that the integration process would require change in rules and agreed to consider the suggestion while framing rules under the DTC.