Jaitley Pledge No Balm for MNCs' Tax Pain

TRANSFER-PRICING WOES Taxmen order cos to pay taxes on ad, marketing & promotion expenses over and above industry average

It would appear that not everyone's got Finance Minister Arun Jaitley's oft-repeated message seeking a reversal in the aggressive policies of the tax department that prevailed under the previous government as the Narendra Modi administration looks to improve India's investment climate and make it more attractive to overseas companies. The transfer-pricing bogey that has haunted multinationals over the past few years still hasn't been entirely laid to rest.

The income-tax department has ordered several MNCs, mostly fastmoving consumer goods (FMCG) companies, to pay taxes on advertising, marketing and sales promotion (AMP) expenses incurred over and above the industry average.

This hard line has been adopted in the latest transferpricing audit as demands have intensifed with January 31 being the last date by which these can be made. The tax department's argument is this: If the Indian subsidiary spends more than the average AMP expenses, then this additional amount is going towards promoting the brand and not the product, justifying the levy. The concept of pegging advertising spend as a proportion of turnover against industry average is an example of the `bright-line test', a rule set by precedent that's inflexible.

This approach flies in the face of the government's avowed aversion to aggressive tax tactics because of their ultimate lack of success.

“Ultra-aggressive taxes have not yielded any revenue,“ Jaitley said at the Economic Times Global Business Summit last week. “Unfair and aggressive taxes momentarily will give me a false belief that my taxation kitty will be very large. But none of the controversial cases has brought me a single rupee of revenue, it has only brought the Indian economy a bad name.“ He reiterated this at Davos on Thursday , saying he would simplify taxes but would not raise even “a rupee in the budget from aggressive taxation“.

The I-T department contends that when a company spends more than the industry average, it's creating “marketing intangibles“. “When a company bears the cost of marketing and advertising, it must co-relate with the benefits, whether in sales or otherwise, resulting from such an activity,“ a tax official said on condition of anonymity.

“If the spend is not corresponding to the benefits, it can be said that the money spent behind the marketing activities is creating marketing intangibles.“

Transfer pricing refers to charges that various entities of a large company levy on each other for various services rendered. Companies that face tax demands based on this extra ad spend include Hindustan Unilever, P&G, L'Oreal, LG and Maruti Suzuki. Industry experts peg the total demand raised by the I-T department on this count at about .` 10,000 crore.

“This matter is a big thorn in the flesh of MNCs,“ said Dinesh Kanabar, CEO of tax advisory Dhruva.

The move has been challenged in the Delhi High Court while some of the MNCs have approached the I-T tribunal on the matter.

The court is expected to decide in the next 10 days. “One is hoping that the judgement is delivered so that the matter is resolved,“ Kanabar said.

“The department is taking an aggressive stand and we have seen demand being raised from many multinationals in last few days,“ said Jeenendra Bhandari, partner, MGB and Co, a tax firm. “In my experience, the bigger demands are raised in the last 10 days (before January 31) by the transfer-pricing officials.“

For instance, a demand of . ` 400 crore was slapped on one of the top three FMCG companies in the last few days, said a person who's aware of this.

“The IT department is not applying any range before they apply AMP. So what is happening is that so many large claims are being made by IT department every year but no actual tax is being collected, as these claims are being challenged,“ said Sanjay Tolia, partner, PwC India, echoing finance minister Arun Jaitley's statement above.

“This is spoiling the country's image at a time when we want more investment in the country,“ said Tolia, who is a transfer-pricing expert.

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ON I-T DEPT'S STAND

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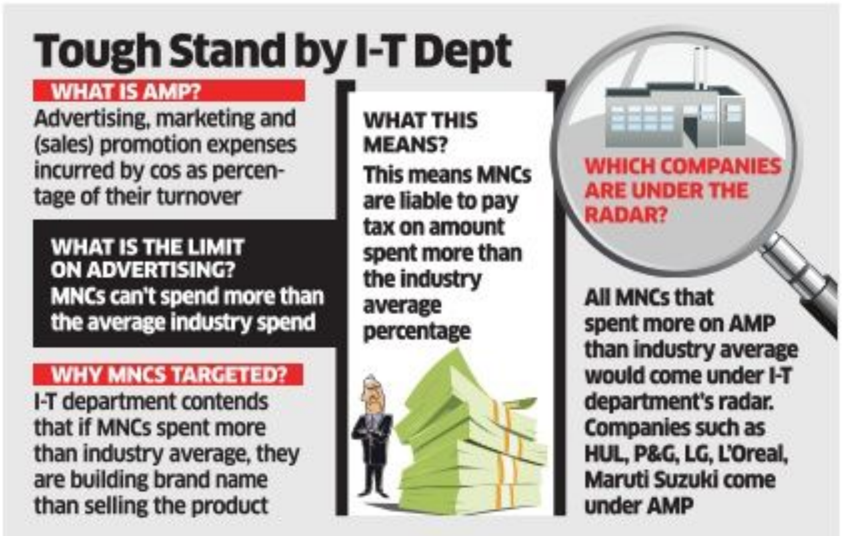

Tax Evasion may Come Under PMLA

The government may prosecute those accused of evading taxes under the Prevention of Money Laundering Act (PMLA) as part of a wideranging crackdown on black money. Further, non-declaration of foreign bank accounts and assets may also be made a criminal offence, according to people who have been briefed on the thinking within the tax authorities and the finance ministry.

Failure to pay income tax could become prosecutable under anti-money laundering laws if the amount evaded exceeds `. 50 lakh, according to a person aware of the deliberations. Under laws currently in place, neglecting to pay income tax is a compoundable offence, that is, offenders can end proceedings by paying a penalty.

Failing to pay service tax, in certain specific situations, and excise duty are criminal offences even now. Such acts could be added to the list of offences to which PMLA is applicable, known as `predicate offences'.

The apex bodies in charge of direct and indirect taxes, the Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC), have held initial consultations to identify offences and define a threshold of evasion beyond which PMLA could be brought into play.

Some of these measures could be part of the forthcoming Budget, some of the people cited earlier said. But a final decision would be taken only after a detailed analysis of the possible impact of such steps on the fragile investment sentiment which the Modi administration is endeavouring to improve, said a government official privy to the development. “There have been some discussions...We are examining as to what could be adequate threshold for these offences,“ said the official.

Concealment of income, non-disclosure of foreign assets including bank accounts, giving false evidence and non-deposit of tax deducted at source are some of the offences that could make it to the list of crimes that could become a predicate offence under PMLA.

“Making tax evasion an offence liable to prosecution is conceptually sound but caution needs to be exercised to ensure that these provisions are not misused,“ said Pratik Jain, Partner, KPMG.

The government faces pressure from the Opposition as well as the judiciary to demonstrate effective measures to tackle black money. The Special Investigation Team on black money headed by Justice MB Shah has suggesting designating income-tax evasion as a criminal offence.

As far as indirect taxes are concerned, clandestine removal and misdeclaration of goods, under-invoicing, availing credit by resorting to fraud, collecting service tax and excise duty but not depositing it with the government and other offences that invite prosecution could make it to the list of predicate offences.Customs offences such as over and under-invoicing of goods are already in the ambit of anti-money laundering law.

During the 2014 election campaign, Modi, as BJP's PM candidate, had made the alleged prevalence of a vast quantum of black money -particular fund kept abroad - part of a narrative of massive corruption supposedly tolerated or even encouraged by the previous government. Modi had also promised vigorous steps to retrieve black money.

“It (applying PMLA to tax evasion) would have to be a political call,“ said another official adding that all aspects need to be weighed, especially the possible impact on investment.

India, which is a member of the Financial Action Task Force, is obliged to designate these offences as tax crimes and bring them under the ambit of its antimoney laundering law in line with the latest global standard prescribed by an inter-governmental body founded by the G7 countries to develop policies to combat money laundering and terror financing. The global plan to bring income-tax offences under the anti-money laundering law was unveiled in February 2012.

Many countries have already incorporated such offences in their money laundering laws. The new government had discussed these proposals ahead of its first budget in July but was not keen to take them up in a hurry as there was little time for detailed discussion.

If these offences become scheduled offences under the anti-money laundering law, they will attract rigorous imprisonment of three to seven years and a fine of up to Rs 5 lakh. Usually, trial is also faster as offences under PMLA are tried in special courts and the onus to prove innocence lies on the accused.

At present launching prosecution for tax offences is a cumbersome process and bringing it under the PMLA could give tax authorities powers to combat black money.

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