NEWSLETTER

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Direct Tax

Income Tax online E-assessment Scheme:

The Government has notified e-assessment (online assessment) scheme for conducting **faceless scrutiny assessment** of all the Income Tax returns. The tax payer will not have to appear personally or through any authorised representative before any tax authority. All the communications with the tax payer will only be through digital mode.

Further, the assessment will be governed by certain pre-defined risk assessment criteria and broad parameters.

The following are the salient features and procedures of the scheme:

- The National e-assessment Centre (NeAC) will issue notice to the tax payer specifying the **reason for selection of their case** for scrutiny assessment;
- The notice will be sent electronically to the **registered email id** or registered mobile number of the tax payer
- The tax payer will have to reply within **15 days** from the date of receipt of the notice. The response will be required to be made through the registered account only and it will be considered successfully submitted once the tax payer receives acknowledgement from the NeAC.
- The NeAC will assign the case to any randomly selected Regional e-assessment Centre **(ReAC)** through automated allocation system
- In case ReAC requires any further information, documents or evidence from the tax payer in connection with the assessment, it will have to make a request to the NeAC and NeAC shall seek the appropriate information from the tax payer. This would mean that all the **communication with the tax payer will be done only by NeAC**. The ReAC which is making the assessment will have no direct communication with the tax payer.
- The ReAC will make a draft order and send it the NeAC which will examine the same in accordance with the risk management criteria and finalise the order after giving opportunity to the assessee in case of any additions are proposed.
- The NeAC after completion of the assessment, transfer all the electronic records of the case to the Assessing officer having jurisdiction over the case for –
    - Collection and recovery of demand;
    - Rectification of mistake;

- Imposition of penalty;
- Giving effect to the appellate order;
- Submission of remand report or
- Proposal seeking sanction for launch of prosecution and filing of complain before the court

- The NeAC may at any stage of assessment, transfer the case to the assessing officer having jurisdiction over such case
- Tax Payer or his authorised representative are **entitled to seek personal hearing** so as to make their oral submission or present their case before the tax authority in any of the units specified in the scheme. Such hearing shall be conducted exclusively through video conferencing in accordance with the procedure laid down.

This is a radical step to reduce interface between tax payer and tax authorities. IT will completely transform the manner in which the assessments are made. Implementation of above faceless online scrutiny assessment will lead to greater transparency in the entire process of assessment and will bring accountability on the tax authorities.

Compiled by: CA Malay Damania, Partner

CONCEPT OF 'FORCE OF ATTRACTION' RULE IN INTERNATIONAL TRANSACTIONS UNDER TAX TREATIES

In our general understanding, **in any international transaction, 'Business Income'** of an Enterprise is taxed in the country of its Residence unless the company has a **'Permanent Establishment' (PE)** in another country wherein the source of the income has arisen ie. The source country. The amount of profit arisen in the source country is required to be computed by treating such a PE as a separate and distinct entity from the enterprise of which it is a PE. The amount of profit is also calculated to the extent the profit attributable to the involvement and activity of the PE in that transaction. If there is no involvement of the PE in any transaction, there is no profit that gets attributable to the existence of that PE and therefore not taxable in the source country. The profit so computed will be subject to taxation in the source country where the income has arisen and the enterprise is required to pay tax in the source country at a rate that is applicable to a foreign company in that country.

The basic principal underlying the principal of FOA rule is that when an enterprise establishes a PE in another country, it brings itself within the jurisdiction of that country to such an extent that such another country acquires right to tax all profits that enterprise derives from their country, whether through the involvement of that PE or otherwise. Therefore, under the FOA rule, mere existence of PE in another country leads to all the profits, that can be said to be derived from that another country, being treated as taxable in that another country. In substance, such extended scope empowers the source country to tax profits of the enterprise also from the **direct sale of similar goods/services** in the source country, **without involvement of the PE**.

Force of Attraction (FOA) in a way **expands the rights of the source country** to tax such business income of an enterprise. All the Developing countries are supporting applicable of this rule so that they can bring more profits to their tax net of the enterprise from the developed countries that carries on business in their country through establishment of PE.

A typical mention of this rule is found in Article 7 on Business Income of the treaties which is reproduced here:

"The profits of an enterprise of a contracting State shall be taxable only in that State unless the enterprise carries on business in the other contracting State through a Permanent Establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; ***(b) sales in that other State of goods and merchandise of the same or similar kind as those sold through that permanent establishment; or(c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.****"*

This essentially mean that if an enterprise has a PE in other country for the purpose of selling goods or merchandise, sales of same or similar kind may be taxed in that other country **even if they are not conducted through the PE** or even if the PE is not involved in that transaction at all.

In some of the treaties the FOA rule is mentioned indirectly. The para 1 in article 7 in such treaties goes like this:

*"The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as it **directly or indirectly** attributable to that permanent establishment."*

Therefore, before coming to any conclusion about taxability of a 'business income' especially when there exists a PE in another country, it is important to verify whether there exists a clause on FOA in the article of the treaty. It is also important to check the **Protocol and Notes** exchanged between the two countries on this clause.

Some of the key countries with which India has FOA rule (directly or indirectly) in the treaties with them are Belgium, Canada, France, Germany, Italy, Japan, Singapore, USA and UK.

Compiled by CA Malay Damania, Partner

AUDIT

DATA ANALYTICS IN AUDITING PROFESSION

Data Analytics

At a basic level data analytics is examining the data available to draw conclusions. The data used by companies is likely to be both internal and external and include quantitative and qualitative data. This is often aided by specialised software which may have to be developed to enable the information from many different sources and formats to be first combined and then analysed.

Bringing together Data Analytics and Auditing

Data analytics can help auditors in improving Audit Quality. Data analytics (especially with help of Artificial Intelligence) in no sense will lead to an elimination of Auditor Jobs. In fact, it will enable the auditor to spend more time in exercising professional judgement. Data analytics will help the audit function in automating some aspects of the identification and assessment of material misstatement risks. It will help in analysis of an entire set of data rather than only a sample set. Data Analytics can bring focus on and identify outlier transactions, unexpected trends, visualize areas of risk in an audit that sampling methods couldn't do. Jon Raphael, who is Deloitte & Touche LLP's Audit Chief Innovation Officer, foresees a variety of AI applications in audit. In an edition of CFO Magazine, he describes tools that can extract key terms and provisions from contracts, visualize populations and findings, and scan financial statements to suggest areas of risk. Data analytics also help the auditors gain a deeper understanding of the client's business.

There are certain shortcomings to the technology too which shall be addressed. The initial cost of acquiring the technology may be high since data analytics in auditing is at a very nascent stage in India. Small audit firms in India form a major chunk of the population of Audit firms and reskilling professionals from such backgrounds may involve a lot of time and cost which might not be feasible for all stakeholders.

Increasing Adoption of Data Analytic Technology in Auditing

- To increase the speed of adoption of such automated processes to analyze data, audit firms must (apart from training existing employees) also start hiring people that possess skills of science, technology, engineering & mathematics and thus address the gap of skill deficiency.

- Efforts must also be taken by educational institutions and update the curriculum to enable auditing with the help of data analytics.
- Even regulatory bodies must identify ways to upgrade their systems and governing regulations in accordance with the technology to facilitate better regulatory processes.
- It must also be kept in mind that the client must update their technology at a similar pace and audit firms adopting this technology shall also help their clients through this process.
- If clients also adopt AI and data analytics, material misstatements & other financial irregularities can be identified as and when they occur, i.e., in real time.
- Ultimately, the investing public will be the beneficiary of higher quality, more insightful audits fueled by big data analysis across clients and industries.

Real Life Applications of Data Analytics in Auditing

- Actual Revenues have been correlated with estimated outcomes and irregularities were identified and worked upon (Company Name: H&R Block)
- Deloitte auditors are already leveraging many of these capabilities with various tools. Argus, Deloitte's first cognitive audit application, "learns" from every human interaction and leverages advanced machine learning techniques and natural language processing to automatically identify and extract key accounting information from any type of electronic document. Document review powered by cognitive technologies can now take a fraction of the time it used to.
- NRV testing – comparing the last time an inventory item was purchased with the last time it was sold and at what price.
- Analysis of revenue trends by product and region.
- Matching purchase orders to invoices and payments.

An article (published in the institute journal) by Financial Express also shows how the government agencies have been directed to share data with each other and identify book tax evaders with the help of Data Analytics. This will help the government in reducing tax evasion and generate revenue at a time when the economy is under pressure.

- Assurance Services Executive Committee (ASEC) of American Institute of Certified Public Accountants meanwhile, has established audit data standards to identify key information needed and provide a common framework for audits. These voluntary IT standards create a standardized format for data fields (e.g., naming, formatting, and levels of data fields) and files that are commonly requested from auditors, with the theory being that if file formats are standardized, any company's system would be capable of producing them in the standardized format.

Conclusion

Data Analytics is a big step forward in technology and Audit Profession must be at the forefront of adoption of this technology to enable the Global economy prosper by improving transparency and quality of audited data. The various stakeholders must work together in collaboration to enable data analytics help the audit function.

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