

Seminar on Anti-avoidance Provisions relating to Income Tax

Analysis of the provisions of General Anti
Avoidance Rule (GAAR)

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Methods of Reducing Tax Liability

- **Tax Evasion**
 - Unlawful and is the result of illegality, suppression, misrepresentation and fraud
- **Tax Avoidance**
 - Legal exploitation of tax laws to one's own advantage.
- **Tax Mitigation**
 - Legitimate claim of exemptions & deductions as per the provisions of the Act (e.g. section 10, Chapter VI-A deductions, etc.)

Pre GAAR - Era

- Judicial Precedents – Legitimate Tax Planning
 - CIT v. Provident Investment Co. Ltd. (32 ITR 190) (SC)
 - McDowell & Co. Ltd vs. Commercial Tax Officer (154 ITR 148)(SC)
 - UOI vs. Azadi Bachao Andolan (263 ITR 706)(SC)
 - Vodafone International Holdings B.V. vs. UOI (341 ITR 1)(SC)

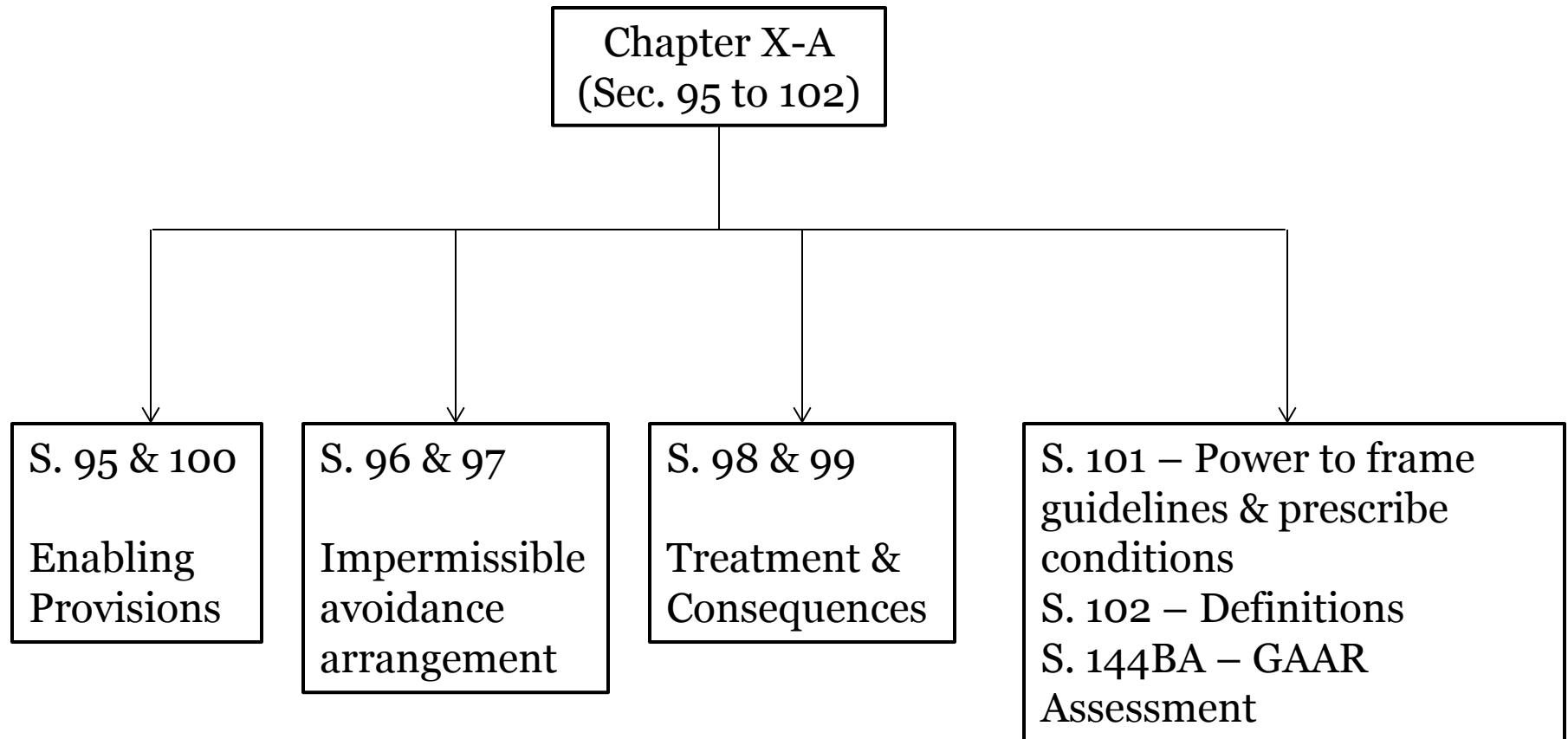
Objectives of GAAR

- Varied judicial precedent on substance over form
- Necessary that the correct tax base be subject to tax
- Counteract and negate abusive tax avoidance arrangements
- Aggressive tax planning with use of sophisticated structures
- Codify the principle of '**Substance Over Form**'
- Deterrent to treaty shopping

History of GAAR

- March 2012 – Finance Bill 2012 proposed GAAR
- July 2012 – Expert Committee to analyse GAAR was set-up under the chairmanship of Dr Parthasarathi Shome (submitted the report in September 2012)
- February 2013 – Finance Act, 2013 deferred GAAR to go-live with effect from April 1, 2016.
- February 2015 – Finance Act, 2013 deferred GAAR to go-live with effect from April 1, 2018.
- June 2016 – CBDT issued notification amending GAAR rules. Grandfathering pre – April 2017 investments.

Basic Scheme of GAAR



- Rules 10U – 10UC
- CBDT Circular 7 of 2017 - FAQs

S. 95 & 100 - Section

- **S. 95** – *Notwithstanding anything contained in the Act an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.*
 - *Enabling Section*
 - *Non-obstante clause – override other provisions of the Act*
- **S. 100** – *The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.*

S. 95 - Analysis

- “assessee” – S. 2(7) – liable to pay tax or assessment proceeding is initiated –
- Applicability of GAAR in the context of section 147 ?
- “*an arrangement entered into by an assessee*” –
 - Should be an assessee before entering into the arrangement?
 - Should be an assessee pursuant to the arrangement?
 - Interpret ‘assessee’ as ‘person’?
- ‘May be declared . . .’ – discretion of the Assessing Officer

S. 95 - Analysis

Consequence

- “*in relation to tax*” – S. 2(43) - income-tax chargeable under the provisions of this Act & fringe benefit tax
 - Interest & penalty
 - Withholding tax
 - Minimum Alternate Tax – 115JB
 - Dividend distribution tax, Tax on buy back of shares – additional income tax
- Definition of ‘tax benefit’ in S. 102(10), specifically refers to ‘tax or **other amount payable under this Act**’ – reference missing in 95(1).

S. 96 - Section

- (1) *An impermissible avoidance arrangement means an **arrangement**, the **main purpose** of which is to obtain a **tax benefit**, and it—*
- (a) creates rights, or obligations, which are not ordinarily created between persons dealing at **arm's length**;*
 - (b) results, directly or indirectly, in the **misuse**, or abuse, of the provisions of this Act;*
 - (c) **lacks commercial substance** or is deemed to lack commercial substance under section 97, in whole or in part; or*
 - (d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for **bona fide** purposes.*

S. 96 - Analysis

- Three limbs
 - Arrangement
 - +
 - Main purpose to obtain tax benefit
 - +
 - One of the four triggers

- All the three conditions are cumulative to declare an arrangement to be an impermissible avoidance arrangement

S. 96 - Arrangement

- S. 102(1) defines Arrangement –
*arrangement **means** any **step** in, or a **part** or **whole** of, any transaction, operation, scheme, agreement or understanding, **whether enforceable or not**, and **includes the alienation of any property** in such transaction, operation, scheme, agreement or understanding.*
- Why specific inclusion of alienation of property – unnecessary?
- S. 102(9) defines Step –
*step **includes** a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement*

S. 96 - Arrangement - Analysis

- Part/step of the arrangement also to be treated as an arrangement for applicability of GAAR (also clarified by Explanation to S. 95) –
 - E.g. Merger of A into B and followed by demerger of demerger of business undertaking of A along with immovable property of B. Merger and demerger transaction to be independently tested for GAAR.
- Is a Unilateral act / non-action covered ?
 - Conversion of stock-in-trade into capital asset or vice-versa is it an arrangement ?
 - Settlement / Declaration of trust is it an arrangement ?
 - Not opting for rights issue is it an arrangement ?

S. 96 - Step v. Entire Arrangement

- S. 96(2) – *An arrangement shall be presumed, **unless it is proved to the contrary by the assessee**, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, **notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.***
- Rule 10UA – *For the purposes of sub-section (1) of section 98, where **a part** of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only.*

S. 96 - Step v. Entire Arrangement

- GAAR will apply to the entire arrangement or only to the step of the arrangement ?
- Application of Rule 10UA to be restricted to 'part of the arrangement' ?
- Presumption by Section 96(2) is only qua obtaining the tax benefit, still one of the four triggers (arm's length . . . bona fide) should be satisfied by the entire arrangement or satisfaction by a step of the arrangement would trigger GAAR for the entire arrangement ?

S. 96 - Tax benefit

Main purpose to obtain tax benefit

• S. 102(10) defines Tax benefit –

"tax benefit" includes,—

*(a) a **reduction or avoidance or deferral of tax or other amount payable under this Act**; or*

(b) an increase in a refund of tax or other amount under this Act; or

*(c) a **reduction** or avoidance or deferral of tax or other amount that would be payable under this Act, **as a result of a tax treaty**; or*

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

*(e) a **reduction in total income**; or*

*(f) an **increase in loss**,*

in the relevant previous year or any other previous year;

S. 96 - Tax benefit - Analysis

- Main purpose
 - Adequate documentation and justification of the arrangement
 - e.g. non-tax benefits of selecting a jurisdiction for creating an SPV for investing in India (e.g. Commercial laws, government laws, trade agreements with other countries, repatriation laws, cost-effective, trade relations with India, setting Asia-Pacific headquarter etc)
 - FAQ 4 – GAAR shall not be invoked merely if the entity is located in tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.
- Reduction of tax payable under this Act –
 - Change of capital gain/IOS to Business income & vice versa.
- Specifically refers to ‘tax or **other amount payable under this Act**’. However, for determining applicability of GAAR, Rule 10U(3)(iv) restricts it to ‘tax’.

S. 96 - Tax benefit - Analysis

- Deferral of Tax
 - No concept of reducing to the present value, the tax payable in future for computation of tax benefit on deferral of tax, as recommended by Shome Committee.
- FAQ No. 9 - the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.
- Tax benefit should be for a specific tax payer or all the parties to the arrangement – 10UA(1)(a) – “for all the parties”
 - E.g. Due to an arrangement instead of Mr. A tax is paid by Mr. B – in a manner that there is no loss to the revenue. GAAR will apply to Mr. A ? – Analogy from FAQ 14 – net benefit may be considered

S. 96 - Four triggers

- Not at Arm's Length
- Represents Misuse or Abuse of the provisions of the Act
- Lacks Commercial Substance
- Entered or carried on in a manner not normally employed for Bona-fide Purposes.

S. 96 - Four triggers - Arm's length

- Language of S. 96(1)(a) – *creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length*
 - Commercial expediency or arm's length price of each transaction can be questioned by the AO ?
- Commercial mala fide purpose – not impacting tax
 - Salary to promoters can be disallowed invoking GAAR?
- Commercial Expediency
 - Can be invoked in case of stress sale of an asset ?

S. 96 - Four triggers - Arm's length

- Hindsight
 - Sale of entire stake in an Airline by one promoter to another Rs. 1/share (substantially less than the quoted price of the shares in the stock market). After three years the Airlines is one of the best performing airline in India.
- Whether sale by the promoter before three years can be questioned ?

S. 96 - Four triggers - Arm's length

- What is arm's length is subjective.
- Arm's Length adequately(?) addressed by SAAR provisions –
 - Chapter X – Transfer Pricing
 - 50C & 50CA – Deemed income (in case of land, building, unlisted shares) for computation of capital gains
 - 56(2)(x) – receipt of cash or property without or inadequate consideration
- *Circular FAQ 1 – “Will GAAR be invoked if SAAR applies?
It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation.
The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.” – Contrary Committee Report*

S. 96 - Four triggers - Arm's length

- GAAR v. SAAR – Bowman A.C.J. in the Canadian case *Geransky vs The Queen* [2001] 2 CTC 2147 at Paragraph 42:
 - *"The Income-tax Act is a statute that is remarkable for its specificity and replete with anti-avoidance provisions designed to counteract specific perceived abuses. Where a taxpayer applies those provisions and manages to avoid the pitfalls the Minister cannot say **"Because you have avoided the shoals and traps of the Act and have not carried out your commercial transaction in a manner that maximizes your tax, I will use GAAR to fill in any gaps not covered by the multitude of specific anti-avoidance provisions"***
- Affirmed by Federal Court of Canada

S. 96 - Four triggers - Arm's length

- If transfer pricing is not applicable to a particular transaction – say the transacting parties are not associated enterprise as defined u/s 92A.
 - Can assessing officer invoke GAAR to determine Arm's Length price for a transaction between AE ?
 - If yes, whether reference has to be made to TPO to determine Arm's length price ?
 - In absence of any method prescribed under Chapter X-A, the method and the judicial precedents in the context of Chapter – X will apply ?
- In case of sale of land (being capital asset), if the market value of land is more than stamp duty value (also being the transaction value), Whether GAAR can be invoked ?

S. 96 - Four triggers - Abuse

- Language of S. 96(1)(b) – results, directly or indirectly, in the **misuse, or abuse**, of the provisions of this Act.
 - Can misuse or abuse be attributable to avoidance of SAAR or is primarily applicable to artificially claiming exemptions & deduction given by the Act ?
 - Artificially complying with the conditions stated u/s 47(xiii b) for conversion of Company into LLP, say by converting the resulting company in the year of demerger so that the condition of turnover is satisfied. GAAR can be invoked ?
 - Circumventing the applicability of S. 79 (disallows brought forward losses in case of certain companies, if there is a change of shareholders carrying more than 51% voting rights) by issue of CCDs with special rights in the management, instead of issuing equity shares. GAAR can be invoked ?

S. 96 - Four triggers - Substance

- Language of S. 96(1)(c) - *lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part.*
 - Commercial substance also to be analysed in non-commercial transaction ?
 - Gift out of natural love and affection
 - Donation for charitable or social cause, CSR activity
 - Group company making good a default by another company

S. 96 - Four triggers - Substance

- *S. 97 - arrangements deemed to lack commercial substance if the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part*
 - E.g. Mr. A gifting to his brother and his brother in-turn gifting to his daughter-in-law.
 - Step 1 – Gift from brother – covered within the definition of relative applicable to section 56(2)(x) – Not taxable
 - Step 2 – Gift from father-in-law – covered within the definition of relative applicable to section 56(2)(x) – Not taxable
 - Direct receipt of gift from brother of father-in-law – Taxable

S. 96 - Four triggers - Substance

- *S. 97 - arrangements deemed to lack commercial substance*
 - **Round trip financing**
Includes any arrangement in which, through a series of transactions—
 - (a) funds are transferred among the parties to the arrangement;*
and
 - (b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter).*
- E.g. round tripping of funds due to tax arbitrage between resident and non-residents (using favourable jurisdictions).

S. 96 - Four triggers - Substance

- Following consideration to be disregarded to decide whether the arrangement is of round tripping or not –
 - *whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;*
 - *the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or*
 - *the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.*
- E.g. Instead of directly advancing loan to subsidiary, H Co. infuses equity in S1 Co. (loss making sub of H Co.) and S1 Co. lends to S2 Co. (profit making sub of H Co.).
 - S2 will claim interest as an expense. S.1 Co. will set-off interest income against losses.

S. 96 - Four triggers - Substance

- *S. 97 - arrangements deemed to lack commercial substance if it involves or includes an **accommodating party**.*
- *S. 97(3) – a party to an arrangement shall be an accommodating party, if the **main purpose** of the direct or indirect **participation** of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a **tax benefit** (but for the provisions of this Chapter) for the assessee **whether or not** the party is a **connected person** in relation to any party to the arrangement.*
- Example –
 - Receipt of gift from brother of father-in-law.
 - Loan to an Indian subsidiary by a UK Holding Co. routed through Mauritius.

S. 96 - Four triggers - Substance

- *S. 97 - arrangements deemed to lack commercial substance if it involves or includes elements that have effect of **offsetting** or cancelling each other.*
 - *E.g. Merger of undertaking and demerger of same undertaking along with immovable property.*
- *S. 97 - arrangements deemed to lack commercial substance if it does not have a **significant effect upon the business risks or net cash flows of any party** to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).*
 - *E.g. Claiming capital loss on capital reduction by 100% subsidiary.*

S. 96 - Four triggers - Substance

- *S. 97 - arrangements deemed to lack commercial substance if it involves or includes a transaction which is conducted **through** one or more **persons** and **disguises** the **value, location, source**, ownership or control of funds which is the subject matter of such transaction*
 - *E.g. P-Notes, benami transactions, placing a deposit with a bank against which the bank advances loan to group company*
- *S. 97 - arrangements deemed to lack commercial substance if it involves the location of an asset or of a transaction or of the **place of residence of any party which is without any substantial commercial purpose** other than obtaining a tax benefit (but for the provisions of this Chapter) for a party*
 - *E.g. Vodafone case, IP Box regime*

S. 96 - Four triggers - Substance

- *S. 97(4) - For the removal of doubts, it is hereby clarified that the following may be **relevant but shall not be sufficient** for determining whether an arrangement lacks commercial substance or not, namely:—*
 - (i) the **period** or time for which the arrangement (including operations therein) exists;*
 - (ii) the fact of **payment of taxes**, directly or indirectly, under the arrangement;*
 - (iii) the fact that an **exit route** (including transfer of any activity or business or operations) is provided by the arrangement.*
- **FAQ 12** – No definite time line (5 to 10 years) for existence of an arrangement for non-applicability of GAAR. Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor.

S. 96 - Four triggers - Bona fide

- Language of S. 96(1)(d) – *is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for **bona fide purposes**.*
 - Bona fide – means an act done good faith and without an intention to de-fraud. Test vis-a-vis the tax department or party to the arrangement ?
 - E.g. Rate of interest on loan = $(\text{Annual Profit}/\text{Loan amount}) * 100$

S. 96 - Relevant FAQs

- **FAQ No. 3** – GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.
- **FAQ No. 8** – GAAR will not be invoked if an arrangement is sanctioned by the Court and the **Court has explicitly and adequately** considered the tax implication while sanctioning an arrangement.
- **FAQ No. 7** – GAAR will not apply to arrangement held permissible by **AAR**.
- **FAQ No. 15** – If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, GAAR will not be invoked for that arrangement in a **subsequent year**.

Burden of Proof

- **S. 96(2)** – if main purpose of a step is to obtain tax benefit the onus is on the assessee to establish that the main purpose of the entire arrangement is other than obtaining a tax benefit.
- **S. 144BA** - *If, the Assessing Officer, at any stage of the assessment or reassessment proceedings before him **having regard to the material and evidence available**, considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement. . . then, he may make a reference to the Principal Commissioner or Commissioner in this regard.*
- **Rule 10UB(1)** mandates the Assessing Officer before making reference to the Commissioner, issue a notice the assessee seeking objections to the applicability of GAAR. The content of the Notice includes basis and reason for applying GAAR

Rule 10U - Exemption

- *Language of Rule 10U(1) – The provisions of Chapter X-A shall not apply to—*
 - (a) an arrangement where the tax benefit in the **relevant assessment year** arising, in aggregate, to **all the parties** to the arrangement does not exceed a sum of rupees **three crore***

*“**tax benefit**” as defined in clause (10) of section 102 and computed in accordance with Chapter X-A shall be with reference to—*

- (a) sub-clauses (a) to (e) of the said clause, the **amount of tax**; and*
- (b) sub-clause (f) of the said clause, **the tax** that would have been chargeable had the **increase in loss** referred to therein been the total income.*

Rule 10U - Exemption

- Whether an arrangement to avoid dividend distribution tax can claim exemption, as the 'tax' saving pursuant to such arrangement is zero ?
- Tax Benefit in Year 1 is Rs. 2 crores, tax benefit in Year 2 is Rs. 3.5 crores and Tax benefit in Year 3 is Rs 1 crore.
 - For which year(s) GAAR can be invoked ?
- Tax benefit to all the parties in an assessment year pursuant to an arrangement should be computed on gross or net basis ?
 - FAQ 14 – Net basis – but only considering tax payable in India.

Rule 10U - Exemption

- **Other exemptions from applicability of GAAR –**
- Foreign Institutional Investor –
 - (i) who is an assessee under the Act;
 - (ii) who has not taken benefit of DTAA; and
 - (iii) who has invested in listed securities, or unlisted securities.
- A non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor.
- Any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from **transfer of investments made before the 1st day of April, 2017** by such person.

Rule 10U - Exemption

- FAQ 5 – Grandfathering available to investments made before 1st April 2017 in respect of instruments **compulsorily convertible** from one form to another, at terms finalized at the time of issue of such instruments and also for shares brought into existence by way of **split or consolidation** of holdings, **or by bonus** issuances in respect of shares acquired prior to 1st April 2017.
- Scope of the word investment –
 - FAQ 6 – As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, **interest, rentals** and for capital appreciation. **Lease contracts and loan arrangements** are, **by themselves, not 'investments'** and hence grandfathering is not available.

S. 98 - Consequences

- Denial of tax benefit (under treaty or the Act)
- Disregarding/ combining /re-characterising any step in, or a part or whole of the arrangement
- Treating the arrangement as if it had not been entered into or carried out
- Disregarding any accommodating party or treating any accommodating part and any other party as one and the same person
- Deeming connected persons as one and the same

S. 98 - Consequences

- Reallocating income, expense, deduction, relief, rebate amongst the parties to the arrangement
- Re-assign place of residence/ situs of asset or transaction (to other than what has been provided under the arrangement)
- Disregarding the corporate structure (“look through”)
- Re-characterize equity-debt, capital receipt – revenue receipt and any expenses, deduction, relief, rebate
- Inclusive definition – not limited to the aforesaid consequences

S. 98 - Consequences

- Corresponding adjustment to other party ?
 - No provision to this effect.
 - FAQ 13 – No

- How will AO decide between alternative consequences ?
 - E.g. Asset located in India or assessee resident of India.

- Primary v. Secondary ‘consequences’ ?
 - Loan is re-characterised as equity and interest is disallowed to payer.
 - Can interest be re-characterised as dividend ? – Yes power to re-characterise. Re-characterisation even for recipient of interest ?
 - DDT to be charged on re-characterisation of interest as dividend ?
 - Not a tax, otherwise yes.
 - Does power of re-characterisation get over definition of ‘dividend’, ‘shareholder’, ‘accumulated profits’ etc.

S. 98 - Consequences

- How will consequences match legal realities ?
 - E.g. FEMA implications if debt is reclassified as equity
- Book profit u/s 115JB can be modified ?
 - Power to re-write financial statements prepared under Companies Act ?
- FAQ 11 – Can GAAR lead to assessment of **notional income** or **disallowance of real expenditure**? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?
 - If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.

S. 98 - Consequences

- Can deny benefit under the tax treaty ?
 - **FAQ 9** – Admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR.
 - Committee Recommendations – Where anti-avoidance rules are provided in a tax treaty in the form of limitation of benefit (as in the Singapore treaty) etc., the GAAR provisions shall not apply overriding the treaty.
 - **FAQ 2** – LOB Clause in the treaty – Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is **sufficiently addressed** by LOB in the treaty, there shall not be an occasion to invoke GAAR.

S. 98 - Consequences

- S. 90(2A) provides that the provisions of GAAR should apply to the taxpayer even if such provisions are not beneficial.
- Article 26 of Vienna Convention – Every treaty in force is binding upon the parties to it and must be performed by them in good faith
- Article 51 of Constitution of India – The State shall endeavour to:
(c) Foster respect for international law and treaty obligation in the dealings of organized peoples with one another
- India Indonesia tax treaty renegotiated in 2012/ India Korea tax treaty renegotiated in 2015 -Provisions of tax treaty shall not prevent a Contracting State from application of its domestic law/ measures concerning tax avoidance or evasion.

Thank You