

# General Anti-Avoidance Rule (GAAR) vs. Transfer Pricing



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**October 13, 2018**

# Tax Planning vs. Avoidance vs. Evasion



## ☞ Tax Planning:-

The tax planning is described as the arrangement of financial activities in a way that the assessee can avail maximum tax benefit by **making best possible use of all the legal benefits**, i.e., deductions, exemptions etc.

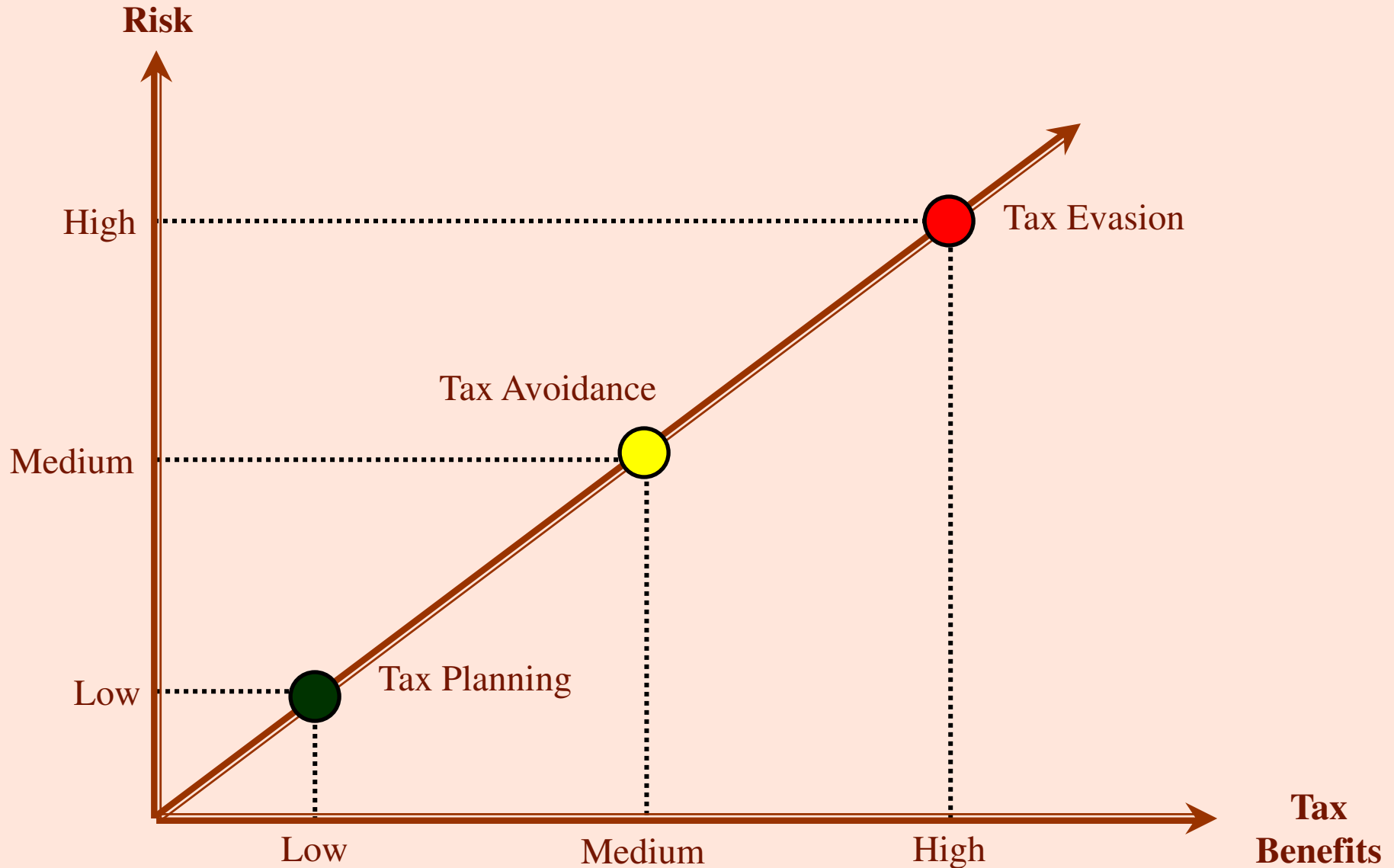
## ☞ Tax Avoidance:-

The tax avoidance is a technique of refraining from tax liability, through just and fair means, **but intends to defeat the fundamental motive of the legislature**. The dividing line amidst the two concepts is thin and blur.

## ☞ Tax Evasion:-

The term Tax Evasion is usually used to mean **any illegal arrangement** where **tax liability is hidden or ignores**, i.e., the tax payer knowingly pays less tax than what he is legally obligated to pay, either by hiding income or information from tax authorities.

# Tax Planning vs. Avoidance vs. Evasion



# Timeline: Substance vs. Form



## Permissible

Duke of Westminster vs. IRC (19 TC 490) (HC)

UOI vs. Azadi Bachao Andolan (263 ITR 706)(SC)

Vodafone International Holdings B.V. vs. UOI (341 ITR 1)

1935

1936

1982

1985

2003

2012

GAAR

Gregory v/s. Helvery (US Supreme Court)

Ramsay vs. IRC (54 TC 101) (HL)

McDowell & Co. Ltd. vs. CTO (154 ITR 148)

## Impermissible

# GAAR in India - Introduction



## ☞ Budget Speech by Finance Minister on 16 March 2012:

*I propose to introduce a General Anti Avoidance Rule (GAAR) in order to counter aggressive tax avoidance schemes, while ensuring that it is used only in appropriate cases, by enabling a review by a GAAR panel.*

- ☞ GAAR provisions were first introduced in the Finance Act, 2012 with effective from AY 2014-15
- ☞ Finance Act, 2013 amended the GAAR provisions on the basis of recommendations of Expert Committee Report and deferred the application to AY 2016-17

# Introduction (Contd...)



- ❧ Finance Act, 2015 further deferred the applicability of GAAR provisions by two years
- ❧ GAAR provisions are now applicable from the FY 2017-18 onwards, i.e. AY 2018-19
- ❧ The provisions of GAAR are contained in Chapter X-A of the Income-tax Act, 1961 (i.e. Sections 95 to 102 and Section 144BA)
- ❧ The procedures for application of GAAR and conditions under which it shall not apply are framed in Income-tax Rules, 1962 (i.e. Rule 10U to Rule 10UC)

# Framework of GAAR Provisions



Section/Rules	Overview
<b>95</b>	<b>Applicability of GAAR</b>
<b>96</b>	<b>Impermissible Avoidance Arrangement (“IAA”)</b>
97	Arrangement of lack commercial substance
98	Consequences of IAA
99	Treatment of connected person and accommodating party
100	Application of Chapter X-A
101	Chapter X-A to be applied in accordance with guidelines to be framed
102	Definitions
<b>144BA</b>	<b>Administration of GAAR</b>
Rule 10U	Exclusions from applicability of Chapter X-A
Rule 10UA	Determination of consequences of IAA
Rule 10UB	Notices and forms
Rule 10UC	Time Limits
Circular No. 7 of 2017	FAQs on GAAR

# GAAR Enabling Provisions



## ☞ **Section 95:** *Applicability of General Anti-Avoidance Rule.*

“(1) **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.....

Explanation.—For the removal of doubts, it is hereby declared that the provisions of **this Chapter may be applied to any step in, or a part of, the arrangement** as they are applicable to the arrangement”

## ☞ **Section 96:** *Impermissible avoidance arrangement.*

(1) An impermissible avoidance arrangement means an arrangement, the **main purpose** of which is to obtain a **tax benefit, and it-**  
..... (a) to (d).



# Anti-Avoidance Tests



- ⌘ Thus, an arrangement shall be an impermissible avoidance arrangement, if:
  - i. the main purpose of the arrangement is to obtain a tax benefit **and**
  - ii. such arrangement falls within the ambit of any of the clauses from (a) to (d) of section 96(1) of the Act (i.e. the anti-avoidance test).
  
- ⌘ The anti-avoidance tests as referred above are as follows:
  - 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**

# GAAR Provisions - A Snapshot



Is there an arrangement

No



Yes

Main purpose of the whole/step  
in/part of the arrangement is to  
obtain tax benefit

No



Yes

Does the arrangement fall in any of  
the above four Anti-avoidance test

No



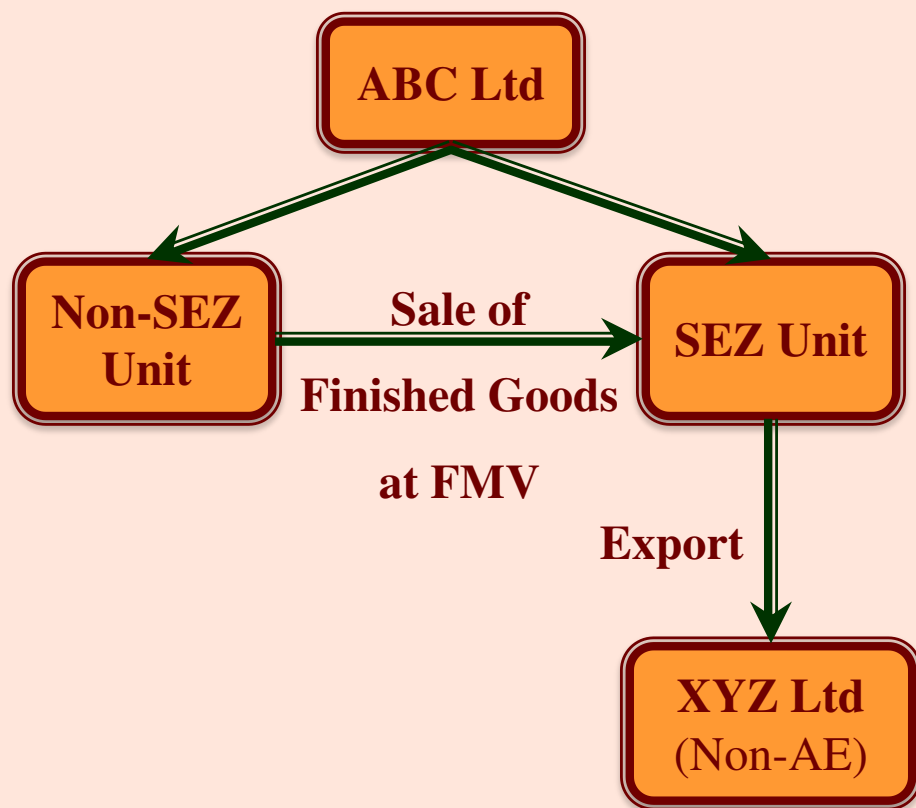
Yes

The arrangement may be an  
Impermissible Avoidance  
Arrangement (IAA)

**GAAR is Applicable**

**GAAR is  
Not Applicable**

# Illustration No. I



ABC Ltd. is engaged in the business of manufacturing agricultural tools and equipments, through its **non-SEZ unit**.

The **SEZ unit** merely carries out invoicing and carries out the purchase and sale of the finished goods.

However, due to the export market fetching a better price, the SEZ unit makes a good profit.

Thus, it is able to show higher profits in the SEZ unit than in the non-SEZ unit, and consequently claims a higher deduction in the computation of income.

**Can GAAR be invoked to deny the tax benefit?**

# GAAR vs. SAAR



- ☞ SAAR is tailor-made to a particular situation or particular instance, such as Transfer Pricing, Clubbing provisions, Limitation of interest, etc.
- ☞ Scope of SAAR is restricted to the instances enumerated in the legislation.
- ☞ SAAR cannot be used to rope-in all types of transactions, which are not founded in economic substance and may results in erosion of the tax base of the country

**Whether AO can invoke GAAR provisions, when SAAR is already applicable?**

# Arm's Length condition in GAAR



- ☞ 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**; .....
  
- ☞ Thus, one would need to examine the principles of arm's length price/market value, to demonstrate that the transactions are at arm's length, and thus, do not fall in the mischief of clause (a)
  
- ☞ If the arrangement is at arm's length then GAAR cannot be invoked under clause (a) of section 96(1) of the Act
  
- ☞ However, one may still have to analyse the other conditions as mentioned in section 96 of the Act [*i.e. clause (b) to (d)*]

# Arm's Length condition (Contd..)



☞ The term **arm's length** is not defined in Chapter X-A of the Act

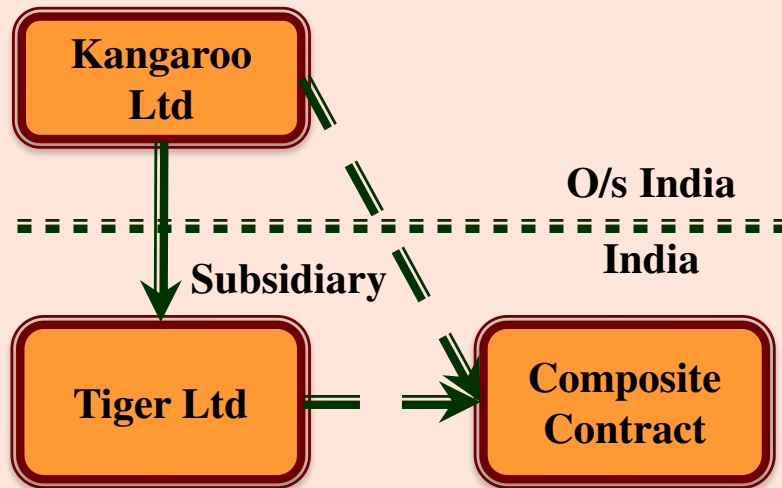
☞ **Section 92F (a):**

“**arm's length price**” means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

**Whether Chapter X provisions can be used to benchmark the arrangement between non-associated enterprises?**

☞ Thus, even in cases where Chapter X does not apply, one can still take the aid of the arm's length principles, to demonstrate that the arrangements are at arm's length as per clause (a) of section 96(1) of the Act

# Illustration No. II



☞ Kangaroo Ltd enters into an agreement (composite contract) with Kingfisher Ltd, for setting up a turnkey automobile assembling plant in India, for an agreed price of INR 500 crores.

☞ The breakup of the agreements is given below:

- a. INR 100 crores for the offshore design and technical know-how
- b. INR 350 crores for offshore supplies of equipment, etc. (Not taxable in India under the Act, no import duty was leviable)
- c. INR 50 crores for local supplies and installation charges.

## Illustration No. II (Contd...)

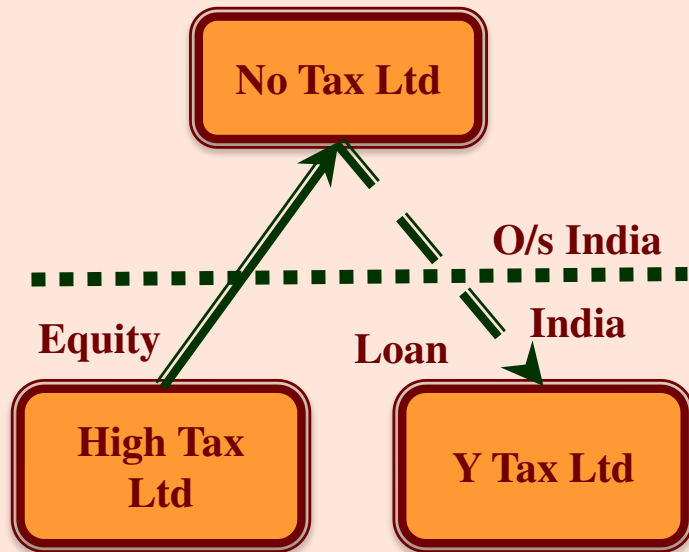


- ❧ During the assessment, the AO/ TPO accepted the ALP of the composite contract, by application of Other Method (using bid documents).
- ❧ Subsequently, AO found that the arrangement with Kangaroo Ltd., was arranged in a manner as to reduce the tax impact in India, without causing any detriment to Tiger Ltd.
- ❧ It was noticed by the AO that an offshore design services would suffer withholding tax in India, and its price was depressed, as compared to the fair market value of offshore design which was around INR 200 crores.
- ❧ The arrangement resulted in a significant tax benefit to the taxpayer.

**Can GAAR be invoked in such case?**



# Illustration III



**Can GAAR still be invoked, even if the transaction was found to be at arm's length?**

- ❧ High Tax Ltd., an Indian company, incorporated a No Tax Ltd. in a tax haven with an equity infusion of USD 1 million.
- ❧ No Tax Ltd. gives a loan of USD 1 million to another subsidiary of High Tax Ltd., incorporated in India. No Tax Ltd. conducts no other business operations.
- ❧ Y Tax Ltd. pay an interest rate @ 10% p.a. and claims a deduction.
- ❧ The TPO evaluates the transaction between Y Tax Ltd. and No Tax Ltd. at arm's length, as the interest rate of 10% has been benchmarked by application of the CUP method.

(Note: as per the tax treaty, interest income of non-resident would be subject to tax @ 10% instead)

# Generalia Specialibus Non Derogant



- ⌘ In the Essar judgment, the Supreme Court held that the provisions provided in the Electricity Act are special and hence will override the general provision of the Limitation Act 1993 (later 1996), applying the very same principle that special law prevails over general law.
- ⌘ The Hon'ble Supreme Court in the case of CIT vs. Shahzada Nand and Sons (60 ITR 392) with respect to above Latin maxim observed as under:
  - “Another rule of construction which is relevant to the present enquiry is expressed in the maxim, generalia specialibus non derogant, which means that when there is a conflict between a general and a special provision, the latter shall prevail.....*
  - .....But this rule of construction is not of universal application. It is subject to the condition that there is nothing in the general provision, expressed or implied, indicating an intention to the contrary...”*

# Generalia Specialibus Non Derogant



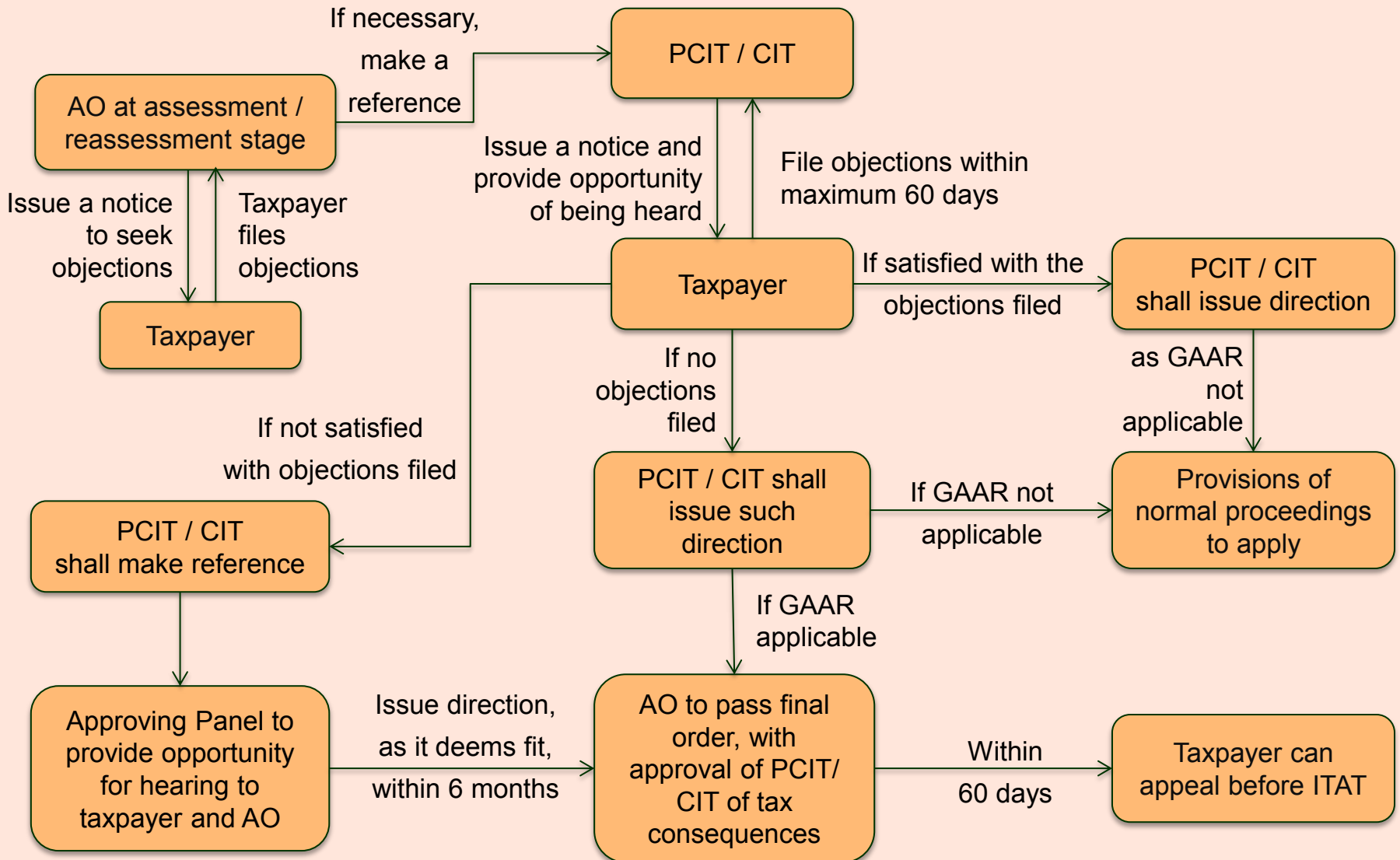
## ☞ Section 100: Application of this Chapter.

*The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.*

☞ The Central Board of Direct Taxes (CBDT) vide its Circular No. 7 of 2017 dated 27-01-2017 clarifies that SAAR may be inadequate to address all situations of tax abuse, an invocation to GAAR provisions may be resorted to even in cases where SAAR provisions exist.

☞ Therefore, it would be worthwhile to see whether the courts may hold GAAR and SAAR (such as Transfer Pricing or Limitation on Interest Deduction, etc.) to be mutually exclusive or what would be the interplay between the two; and whether fulfilment of conditions as legislated under SAAR, would protect the taxpayer from the wider and general provisions of GAAR.

# Administration of GAAR





# THANK YOU

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