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A: Anti-avoidance measures of general nature and scope – GAAR and other rules

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Summary and conclusions

Governments have countered tax evasion by streamlining and tapping flows of relevant domestic and international information, through invasive measures like searches and surveys, and by introducing various deterrent penalty provisions in the tax laws. Tax departments have viewed tax evasion and tax avoidance at a par with each other on the premise that both have a negative impact on the collection of taxes. The provisions of the GAAR were first brought into the statute book in the year 2013 and were made effective from 1 April 2017 under Chapter X-A of the Income-tax Act 1961(TA). They are the first statutory general anti-avoidance rules in India.

The GAAR implementation Rules, provide three important safeguards: (i) a monetary threshold for the application of the GAAR; (ii) an exemption for foreign institutional investors (FIIs) that do not avail themselves of the benefits of a tax treaty and that invest in securities with the prior permission of the competent authority and in accordance with the Securities and Exchange Board of India; and (iii) non-applicability of the provisions of the GAAR to investments made prior to the effective date of applicability of the GAAR.

The overall scheme of the GAAR under the Indian statute aligns itself with the principle of substance over form. The enabling provision provides that an arrangement entered into by the taxpayer may be declared to be an impermissible avoidance arrangement and the consequence in relation to the tax arising therefrom may be determined in accordance with the provisions of the Chapter. There are two limbs to the applicability of the GAAR. First limb is to identify the existence of an impermissible avoidance arrangement that results in a tax benefit. The second limb empowers the revenue authorities to determine the consequences of this.

An impermissible avoidance arrangement is defined as an arrangement, the main purpose of which is to obtain a tax benefit and, in addition to this, the arrangement involves any one of four elements, i.e. a) the arrangement results in obligations which are not ordinarily created between parties dealing at arm's length; b) the arrangement lacks commercial substance; c) the arrangement involves abuse or misuse of the law and d) the arrangement is not entered into for a bona fide purpose. Thus, to qualify as an impermissible avoidance arrangement, every arrangement is bound to undergo a dual test, primarily a tax benefit test and a substance test.

Once it has been determined that there is an impermissible avoidance arrangement, the tax authorities have been empowered to determine the tax consequences of this by disregarding an arrangement in its entirety or in part and/or by recharacterising the income

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between the parties involved. The powers given in the statute are wide enough to change the entire framework of the transaction and the income arising from it amongst all parties involved in the transaction.

Certain safeguards have been provided for controlling the implementation of the GAAR and, therefore, it has been stipulated that the GAAR shall not apply to an arrangement in which the tax benefit in the relevant tax assessment year arising, in aggregate, for all the parties to the arrangement does not exceed a sum of INR 30 million.

The GAAR, as originally introduced, had been perceived by taxpayers as creating unpredictability with respect to the tax outcome and consequently for business. There were fears of indiscriminate application of the law. This has been addressed by the Government through well-thought-out safeguards, which have been incorporated in the tax law and rules. In the determination of the total income of a taxpayer, the Assessing Officer (AO) may, if he considers it necessary, declare an arrangement to be an impermissible avoidance arrangement. He would, however, have to make a reference in this regard to the Commissioner or Principal Chief Commissioner of Income Tax (PCCIT), who would, on being satisfied that the GAAR applies, issue a notice to the taxpayer to submit his objections. When the PCCIT is satisfied that the provisions of the GAAR are not to be invoked, then he would intimate this decision to the AO and the taxpayer, and the matter raised by the AO would be closed. When the taxpayer files objections and the Commissioner, after a hearing, is of the opinion that the provisions of the GAAR apply, he would have to refer the case to an Approving Panel. After providing an opportunity to the AO and the taxpayer to speak, the Panel would issue directions on whether the GAAR applies or not. No appeal may be made against the directions issued by the Approving Panel and the decision is binding on both the taxpayer and the Tax Department. The Chairperson of the Approving Panel shall be a person who is or has been a judge of the High Court. There are three levels at which the application of the GAAR would be analysed: at the level of the AO, at the level of the Principal Commissioner and, finally, by a panel headed by a judge of a High Court. The above process pre-empts the GAAR provisions being applied indiscriminately by the Tax Department.

Conclusion

In India, the GAAR provisions took effect as of 1 April 2017 and, therefore, the administration of the law cannot be commented on. Whether the GAAR shall be good or bad from a national tax and business perspective will, for the moment, be an issue of continuing debate. The law appears to be objective and the safety provisions in its application ensure that it would be used only as an effective tool to curb tax avoidance.

1 General Anti-Avoidance Rules or Doctrines

1.1. General Overview

From time immemorial, taxpayers have considered it an inalienable right to arrange their affairs in a manner so as to reduce their tax liability. Obtaining tax benefits through genuine tax planning does not invalidate it, unless there is a specific law overrules it. In the McDowell

case,[3] the Supreme Court held that "*tax planning may be legitimate, provided it is done within the frame-work of the law. However, a colourable device cannot be a part of tax planning*." Tax evasion, on the other hand, is illegal and is carried out by misrepresentation, fraud, underreporting and the non-disclosure of income. Governments have countered the latter by streamlining and tapping flows of relevant domestic and international information through invasive measures like searches and surveys, and by introducing various deterrent penalty provisions in the tax laws. The response of Governments to tax avoidance has, however, been cautious and moderated by the view that investment and business may be affected adversely. Specific or Targeted Anti-Avoidance Rules (SAAR/TAAR) have been legislated, and at times with retrospective effect, in order to breach schemes or transactions which lack commercial sense and substance. Prior to it being legislated, there was a judicial GAAR in India with which the courts have pierced the corporate veil and invalidated transactions or, after post-examination, held them to lie within the four corners of the law. Tax departments have viewed tax evasion and tax avoidance on a par with each other on the premise that both have a negative impact on the collection of taxes. Historically, therefore, both tax evasion and tax avoidance have been challenged.

Tax law in India has had SAARs over the years, which are distinct from a GAAR. These were set up to target specific, known arrangements of tax avoidance. Such rules were considered to be effective and the provided certainty to taxpayers. Domestic and, even more so, international tax avoidance has been controversial in India, attracting the attention of Parliament and the media. Schemes to evade tax have been addressed by the Government in a piecemeal fashion through specific provisions introduced in the domestic tax statute. In the international arena, the India-Mauritius Double Taxation Avoidance Agreement (DTAA) has been a bone of contention between the Tax Department in India and the investors from Mauritius. The Indian economy was liberalised in 1991 and non-residents were allowed to invest in shares and to buy and sell on the stock exchange. Mauritius introduced the Mauritius Offshore Business Activities Act and also amended their tax laws to provide for capital gains tax-exemption on the sale of shares. The Indo-Mauritius treaty in existence since 1983 provided for the taxation of capital gains on the basis of the residence of the seller of the shares. Thereafter, it was well known that the treaty began to be used for treaty shopping. Attempts to deny the treaty benefit were made by the Tax Department in India. It was, however, kept alive by the Government because it became a channel for foreign investment flowing into India. When treaty benefits were denied in a number of assessments, the Government of India issued a Circular[4] which laid down that the residence of a person should be determined on the basis of a Tax Residence Certificate issued by the Government of Mauritius. The Tax Department was consequently pre-empted from enquiring into the actual residence of an investor. The Circular was challenged in a public interest litigation for treaty abuse and the Government itself litigated that the Circular should prevail. The Supreme Court concluded that such treaty shopping would be allowed for economic reasons, particularly as the Government was interested in generating the flow foreign investment into the country. It was also observed by the Supreme Court that there was no "limitation of benefit" article provided in the treaty and nor were there any anti-avoidance rules in the domestic statute. In this context, a Protocol was signed with Singapore in 2005 which allowed a similar capital gains tax treatment, although a limitation of benefits

[3] McDowell & Co. Ltd. v. CTO (1985) 154 ITR 148 (SC).

[4] Circular: No 789, dated 13-4-2000.

provision was incorporated.

The immediate background to the final introduction of the GAAR would not be complete without referring to the Vodafone case.[5] No treaty was involved. The transaction involving the transfer of shares in a Cayman Island company was performed between two non-residents. The Cayman Island Company held substantial assets in India and the Tax Department's contention was that, in substance, the underlying assets stood transferred. The question was whether the transfer was subject to capital gains tax under Indian law and whether the buyer was liable to withhold tax from the consideration payable. The questions raised before the Supreme Court were: a) Whether gains were taxable in India? b) Where was the situs of the shares in the Cayman Island Company? c) Did the transaction result in the transfer of any asset in India? d) Was the buyer liable to withhold tax?

The Supreme Court held that the shares in the Cayman Island Company were situated outside India, i.e. in Cayman Islands. Gains arising from the sale of shares were not taxable in India and there was no liability to withhold tax from the sale consideration. The Supreme Court observed, with reference to Multi- National Companies, that, "*It is often said that insufficient legislation in the countries where they operate gives opportunities for money laundering, tax evasion, etc. and, hence, it is imperative that the Indian Parliament should address all these issues with the utmost urgency.*" The Court went on to state that tax avoidance is a problem faced by many countries and all share an aim to combat it. The Court also referred to the legislative measures taken to increase scrutiny of transactions conducted by non-residents. The decision of the highest Court was rendered in 2012 and it noted the proposed amendments in the Income Tax Act in respect of the GAAR.

Revenue has always perceived the use of the Mauritius treaty by taxpayers to be aggressive tax avoidance. Tax avoidance on the domestic scene has also been considered to be a serious problem. The Courts made fine distinctions and, in many cases, held that even though there was no provision in the statute, the corporate veil could be pierced. In this regard, there are a number of Court decisions. Judicial GAAR became a common term. However, in view of differing decisions in India and in the UK, the judge-made GAAR probably did not give any certainty to the taxpayer or to the Revenue. For the first time, the need for a GAAR was expressed by the Government in the Document of 2009 in the following words,

"*Tax avoidance, like tax evasion, seriously undermines the achievements of the public finance objective of collecting revenues in an efficient, equitable and effective manner. Sectors that provide a greater opportunity for tax avoidance tend to cause distortions in the allocation of resources … On considerations of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity.*

In the past, response to tax avoidance has been the introduction of legislative amendments to deal with specific instances of tax avoidance. Since the liberalisation of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. This problem has been further compounded by tax-avoidance arrangements spanning across several tax jurisdictions. This has led to a severe erosion of the tax base …

In view of the above, it is necessary and desirable to introduce a general anti-avoidance rule which will serve as a deterrent against such practices. This is also consistent with the international trend."

The concept of a GAAR was first introduced under the Direct Tax Code 2009 (a code

[5] Vodafone International Holdings BV v. Union of India, (2012) 6 SCC 613.

introduced to replace the Indian tax statute 'Income Tax Act, 1961') and continued without significant changes in the Direct Tax Code 2010. Later the introduction of the Direct Tax Code to replace the Income Tax Act, 1961 ('ITA') was not considered necessary by the Government and the provisions of the GAAR were introduced in the Finance Bill of 2012[6] and were enacted to take effect as of 1-4-2014. The GAAR provisions were omitted by the Finance Act, 2013. Considering the impact on foreign direct investment and business, a committee headed by Dr. Parthasarthi Shome (Shome Committee) was formed to analyse the entire framework of the GAAR, hold public consultations and suggest possible amendments. Finally, the Finance Act 2013 introduced a new Chapter X-A into ITA, which was first proposed to be made effective as from 1 April 2015 (relevant to the assessment year commencing from 1 April 2016). However, the effective date of implementation was deferred for two consecutive years and, finally, they were made effective from the financial year commencing on 1 April 2017 (relevant to the assessment year commencing from 1 April 2018). The new version of the Indian GAAR includes many of the Shome Committee's recommendations. The GAAR implementation Rules[7] provide for three important safeguards: (i) a monetary threshold for the application of the GAAR; (ii) an exemption for foreign institutional investors (FIIs) that do not avail themselves of the benefits of a tax treaty and that invest in securities with the prior permission of the competent authority and in accordance with the Securities and Exchange Board of India; and (iii) non-applicability of the provisions of the GAAR to investments made prior to the effective date of the GAAR's applicability.

1.2. The tax-avoidance scheme, arrangement or transaction

The overall scheme of the GAAR under the Indian statute realigns itself to the principle of substance over form. The enabling provision[8] provides that an arrangement[9] entered into by the taxpayer may be declared to be an impermissible avoidance arrangement[10] and the consequence[11] in relation to tax arising from this may be determined in accordance with the provisions of the Chapter.

An arrangement is an impermissible avoidance arrangement if it meets a two-point test, i.e. (a) its main purpose is to obtain a tax benefit, and (b) it fulfils the tainted element test. The tainted element test refers to an arrangement resulting in - (i) the creation of rights or obligations which are not ordinarily created between persons dealing at arm's length; (ii) the misuse or abuse, directly or indirectly, of the provisions of the ITA; (iii) a lack of commercial substance or deemed to lack commercial substance[12] or (iv) an arrangement entered into or carried out by means or in a manner which is not ordinarily employed for bona fide purposes.

6 Finance Bill is an annual Bill presented by the Finance Minister in the Parliament for proposing the rate of tax for the upcoming financial year and changes in the tax laws.

7 Rule 10U to 10UC were inserted by the IT (Seventeenth Amendment) Rules, 2013, w.e.f. 1-4-2016 Income Tax Rules, 1962.

8 Sec 95 of ITA.

9 Sec 102(1) of ITA defines the term "arrangement" to mean any step in, or that is a part or the whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, including the alienation of any property in such a transaction, operation, scheme, agreement or understanding.

10 Sec 96 of ITA defines impermissible avoidance arrangement.

11 Sec 98 of ITA deals with the consequences of an impermissible avoidance arrangement.

12 Sec 97 of ITA defines situation in which an arrangement is deemed to lack commercial substance.

1.3. The tax benefit, gain or advantage

The term 'impermissible avoidance arrangement' has to be read in conjunction with the term 'tax benefit', which has been defined in a broad manner to cover principally:

a) a *reduction* or *avoidance* or *deferral* of tax or another *amount payable* under the Act,[13] including an increase in a refund of such tax or other amount;
b) a reduction or avoidance or deferral of tax or another amount that would be payable under this Act *as a result of a tax treaty,* including an increase in a refund of such tax or other amount;
c) a reduction in total income, including an increase in loss.

The definition of the term 'tax benefit' includes even that benefit arising in accordance with the provisions of the double taxation avoidance agreement entered into by India. The benefit under the tax treaty may be either in the form of a reduction of the rate of tax or an elimination of tax by transferring the right of tax to another nation, etc. The term 'tax' has not been defined specifically under the GAAR provisions. Therefore the definition of the term 'tax' under section 2(43) of the Act, which applies, would mean income tax that is chargeable under the provisions of this Act and that includes the fringe benefit tax.[14]

Even when the scope of the term 'tax' is restricted to income tax (and not other levies) for the purpose of 'tax benefit', it is imperative to note that the definition of 'tax benefit' seeks to also cover instances of the reduction or avoidance or deferral of tax or any other amount payable under the Act. Thus, arrangements entered into with main purpose of obtaining a benefit in respect of levies such as interest, penalty and other taxes, such as Dividend Distribution Tax and buy-back tax, should also be regarded as arrangements entered into with main purpose of obtaining a tax benefit.

The fundamental question is when would the provisions of the GAAR be triggered – at the time when the arrangement has been entered into for obtaining a tax benefit or when the actual tax benefit arises? In this regard, an "arrangement" has been defined to mean a step in, or a part or the whole of any transaction, operation, scheme, agreement or understanding. The definition presupposes the existence of a tax benefit to attract the GAAR provisions. The definition of tax benefit is broad enough even to include any deferral of tax. Deferral of tax, as understood internationally, means a postponement of the payment of a tax liability. There would be many instances when a transaction or arrangement may not result in an immediate tax benefit or even a deferral of an immediate tax benefit. These instances are well understood in a scenario in which overseas inbound or outbound investment structures are planned and created methodically, resulting in no tax benefit at the planning stage. One of the examples can be the setting up of an overseas holding company for the purpose of holding investments in various operating companies. However, in such cases, tax benefits may arise at a later stage when operating companies start generating profits and surplus funds are repatriated by way of dividends or interests or through any other mode, as the case may be. In cases where an arrangement results in a tax benefit in the form of a deferral of tax, the question of how the amount of tax benefit would be computed needs to be considered. In cases of tax deferral, the only benefit to the taxpayer is not paying taxes in one year, but paying it in a later year. Overall, there may not be any tax benefit other than the benefit in terms of the present value of money. In its report, the

[13] Indian Income Tax Act, 1961.

[14] Fringe Benefit Tax is not levied currently.

Shome Committee had recommended that, in such cases, the tax benefit should be computed in the year of deferral as the amount of taxes not paid in that year due to the tax-avoidance scheme, which exceeds the present value of the money paid for corresponding taxes in subsequent years. It was suggested that the present value of money should be ascertained based on the rate of interest charged under the Act for a shortfall of tax payment under the existing provisions.[15] However in this regard, there is no such provision in the Act or Rules. It may therefore be understood that a 'tax benefit' would be considered in the year in which it arises or in the year when a transaction giving rise to the benefit gets deferred to a future year.

Once the condition of obtaining a tax benefit through an arrangement is met, it has to be seen whether the specific conditions laid down to deem a particular transaction/ arrangement as an impermissible avoidance arrangement are fulfilled. If a particular transaction is determined to be covered under the scope of one or more of these conditions, then the transaction shall be declared as impermissible.

1.4. The taxpayer's purpose or intent

The definition of the term 'impermissible avoidance arrangement' has to be read along with the important phrase "main purpose". The latter is not defined under the provisions of the Act. However, in this context, a meaning given in South Africa in a discussion paper on tax avoidance released in November 2005 is that the word "main" in the same context is "*generally construed to mean predominant*". It further goes on to explain, by way of an example, that if a transaction has both a tax and a commercial purpose, then the test of the main purpose would be satisfied only if the tax purpose is the predominant one. Thus, one view could be that the 'main purpose' test is a subjective test and its satisfaction may differ from case to case. Para 36 of the Commentary on Article 1 of the UN Model Double Taxation Convention, albeit in the context of the inclusion of general anti-abuse rules in a tax treaty, expresses the apprehension that the words "the main purpose" would impose an unrealistically high threshold that would require tax administrations to establish that obtaining tax benefits is objectively more important than the combination of all other alleged purposes, which would risk rendering the provision ineffective.

1.5. The consequences of the GAAR application to a given case

The overall scheme of the GAAR provisions consists of two limbs. The first limb is to identify and declare the existence of an impermissible avoidance arrangement. The second limb empowers the revenue authorities to determine the consequences of this. The consequence of applying the GAAR is significant, as it operates according to the doctrine of substance over form. Section 98 stipulates the manner in which the consequences relating to the taxing of an arrangement may be determined after it has been declared to be an impermissible avoidance arrangement. It provides for certain illustrative, but not exhaustive methods for the determination of tax consequences. However, it also provides that once the arrangement is held to be impermissible, the consequences of the arrangement in relation to the tax

[15] Section 234B of ITA.

implication (including a denial of benefit under a tax treaty) shall be determined in such a manner as is deemed appropriate in the circumstances of the case. Thus, the provisions empower the tax authority to evaluate the impermissible arrangement in substance and to eliminate that part of an arrangement which is considered to be giving rise to the tax benefit. For this purpose, the power given to the tax authorities includes the denial of a tax benefit or a benefit under a treaty. The consequences of an impermissible avoidance arrangement mentioned in section 98(1) of the ITA are:

a) disregarding, combining or recharacterising any step in, or a part of or the whole of the impermissible avoidance arrangement;
b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;
c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining the tax treatment of any amount;
e) reallocating between the parties to the arrangement any accrual or receipt of a capital or revenue nature; or any expenditure, deduction, relief or rebate;
f) treating the place of residence of any party to the arrangement ; or the situs of an asset or of a transaction, to be at a place other than the place of residence, the location of the asset or the location of the transaction as provided under the arrangement; or
g) considering or looking through any arrangement by disregarding any corporate structure.

Therefore, tax authorities have been empowered to determine tax consequences in case of impermissible avoidance arrangement by disregarding an arrangement in its entirety or in part and or by recharacterising the income between the parties involved.

Disregarding or recharacterisation of a transaction

After the identification of a transaction as an impermissible avoidance arrangement, there could be two situations. Firstly, when authorities cannot find an alternative transaction to the identified impermissible transaction and therefore may disregard the transaction. Secondly, authorities may recharacterise the whole or even a part of the transaction.

In either of the scenarios, a transaction may be real, but its characterisation or legal relationship is not acceptable for tax purposes. The reason for disregarding a transaction could be that the legal/contractual elements of the transaction do not correspond to the essential tax characterisation provided by the taxpayer. For example, an assignment of a running contract by a profit-making entity to a loss-making entity for no additional consideration may be disregarded because the assignment is made only for the utilisation of the losses to set off against profits generated from the contract. The objective in transferring the contract under what appears to be an 'assignment' is such that the "loss-making entity" can offset profits against accumulated losses which would otherwise be lost due to expiry of the limitation period. Another example is the transfer of property to a partnership and the later distribution of that property or money by the partnership to that contributor might be treated as a disguised sale or as an exchange of property.

A tax benefit derived as a result of an impermissible tax-avoidance arrangement may be denied mainly by: a) recharacterising the transaction; b) disregarding the transaction; c) reallocating the income between the parties; and d) disregarding any corporate structure.

a. Recharacterisation of a transaction

One way to apply the doctrine of substance over the form to a transaction is to re-characterise the transaction in view of the real substance according to the law. The intent of the parties is given paramount importance and therefore recharacterisation should not be done only with the objective to reach a favourable result. Characterisation by a taxpayer cannot be disturbed unless the transaction can be identified as having another nature. For example, the treatment of a loan as equity or vice versa; a dividend is treated as proceeds from a sale rather than as a dividend when the dividend represents a recovery of the price paid for the shares and the payment of the dividend is either controlled by the shareholder or is a part of an arrangement involving the purchase of shares and the payment of a dividend; a transaction involving the issuance of a compulsorily convertible instrument at a fixed conversion ratio; a transaction of a sale and lease back. As a matter of fact, to determine the nature of a transaction for tax purposes, the form also matters. The availability of an alternative option may not automatically lead to a change in characterisation for tax purposes. In other words, a mere subjective intention may not, on its own, be sufficient to alter the characterisation of a transaction for tax purposes.

The GAAR authorises the Revenue to ignore other provisions in the Act or to re-characterise the nature of a transaction in a manner that denies the tax benefit sought. Therefore, the GAAR could result in a change in the characterisation of a transaction even in the application of tax treaties. Recharacterisation under the GAAR might include disregarding the existence of an entity or ignoring a particular transaction or provision of the Act. Under the ITA, there is an existing provision that, in relation to a taxpayer to whom a tax treaty applies, the provisions of the Act "*shall apply to the extent they are more beneficial to the assessee*". A subsequent amendment overrides this provision in the case of a non-resident taxpayer entitled to a treaty benefit in a case to which the GAAR applies.

When there is no specific anti-avoidance provision in law applicable to a transaction constituting an avoidance scheme, the denial of tax avoidance is achieved by denying the artificial construction. The revenue authority in that case may recharacterise the transaction according to the true intention of the parties and apply the tax treatment accordingly. Such recharacterisation is based on fact-finding and the true intention and interpretation of the relevant provisions.

b. Disregarding a transaction/structure

If a tax payer arranges his affairs in such a manner that he remains within the purview of the law, but still avoids tax through a transaction that offends or runs contrary to the intent or purpose of the subject provisions, the GAAR provisions would apply. When there are specific provisions which give benefits to the taxpayer (such as setting up a business unit in SEZ or an industrially backward area) and the taxpayer avails himself of them, there cannot be avoidance. But when the arrangement seeks to divert income from one taxpayer to another, or when the arrangement is artificial, contrived or out of the ordinary, this might indicate that the arrangement exists to avoid tax. The consequence could be that such a transaction shall be disregarded, notwithstanding the legal structure.

If the transactions are preordained and lack commercial content, and are inserted with the sole object of tax avoidance, then they could be disregarded. The disregard of transactions for fiscal purposes means fiscal nullity. Transactions at any point in a series or in a chain

could be declared to be impermissible and that would impact the arrangement as a whole. A commercial motive may, however, be sufficient to protect a scheme from the operation of the GAAR.

The doctrine of the preordained series of transactions was propounded by Lord Brightman in *Furniss v. Dawson [1984] 1 All ER 530 (HL)*. He wrote, "*Firstly, there must be a pre-ordained series of transactions or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax –not 'no business effect.' If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute to be applied.*" Lord Fraser said: "*The true principle of the decision in Ramsay was that the fiscal consequences of a pre-ordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual of the dual transaction separately.*"

The true legal nature of a transaction would have to be ascertained. In this analysis, the transaction would have to be looked at as a whole and not by adopting a dissecting approach. The Revenue cannot start with asking the question as to whether the impugned transaction is a tax deferment or a saving device, but it should apply the 'look at test' to ascertain its true legal nature.- In the case of Vodafone, learned Justice S. H. Kapadia observed:

"*... Holding Structures are recognised in corporate as well as tax laws. Special Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India, be it in company law, the takeover code under SEBI or even under the income tax law.*

When it comes to the taxation of a Holding Structure, at the threshold, the burden rests with the Revenue to allege and establish abuse in the sense of tax avoidance in the creation and/or use of such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the "substance-over-form" principle or the "piercing the corporate veil" test only after it is able to establish, on the basis of the facts and circumstances surrounding the transaction, that the impugned transaction is a sham or tax avoidant. To give an example, if a structure is used for circular trading or round tripping or to pay bribes, then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity. Similarly, in a case where the Revenue finds that, in a Holding Structure, an entity which has no commercial or business substance has been interposed only to avoid tax, then in such cases, when applying the test of fiscal nullity, it would be open to the Revenue to discard such inter-positioning of that entity."

Thus, the courts have been upholding the revenue's right to disregard the consequences of the transactions, even in respect of those which are genuinely undertaken, if their main purpose is to avoid tax. The taxing authority is entitled and is indeed bound to determine the true legal relationship resulting from a transaction.[16] In order to determine whether a transaction of creating a partnership is a sham or an illusionary transaction or a device or ruse, the Income Tax Officer is entitled to penetrate the veil covering it and thus ascertain the truth. This he can also do even when the partnership is genuine.[17] Law permits the courts to lift the corporate veil to ascertain "business realities" and in order to ascertain where the real control and beneficial undertaking lie. The decisions of the Supreme Court in Juggilal

[16] Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd. [1986] 157 ITR 77 (SC), CIT v. Durga Prasad More [1971] 82 ITR 540 (SC) and CIT v. L.N. Dalmia [1994] 207 ITR 89 (Cal.).

[17] Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC) and also CIT v. Smt. Padma S. Acharya [1996].

Kamlapat v. CIT [1969] 73 ITR 702 and Chandulal Harjiwandas v. CIT 1967] 63 ITR 627 are the examples in which the court has lifted the corporate veil as the concept of corporate veil was used for tax evasion or to circumvent the tax obligation. The Supreme Court has upheld the right of the tax authorities to go behind the corporate facade to look at the economic reality of the transactions if the shell of the corporate entity is used for tax evasion or to circumvent tax obligations.

In the context of the powers to disregard a structure or to reallocate the income in the hands of the transacting parties, the importance of the term 'accommodating party', which includes connected persons, is important. An 'accommodating party' is a party to an arrangement if the main purpose of its participation in an arrangement is to obtain a tax benefit for a taxpayer, whether or not the party is a connected person in relation to any party to the arrangement. Section 99 of the ITA provides for the treatment of a connected person and accommodating party. As per section 99, in determining whether a tax benefit exists, the parties who are connected persons in relation to each other may be treated as one and the same person. Another consequence of an impermissible avoidance arrangement is that income or expenditure may be reallocated between the parties to the arrangement.

Connected persons may be regarded as one and the same person. Any accommodating party may be disregarded. In the treatment of connected persons and an accommodating party, the accommodating party may be disregarded. Furthermore, the arrangement may be looked through by disregarding any corporate structure. The term 'connected person' has been defined under section 102(4) of the ITA to mean any person who is connected directly or indirectly to another person and further provides an inclusive list of persons who would be regarded as connected persons. The definition of the term implies a wider scope than the categories listed in the ITA. The specific categories of persons who would be regarded as connected persons refers to any relative of an individual, any director of a company or any relative of such director, any partner or member of a firm, any individual who has a substantial interest in the business of a person, etc.

The term 'relative' has been defined to mean, i) the spouse of the individual; ii) the brother or sister of the individual; iii) the brother or sister of the spouse of the individual; iv) the brother or sister of either of the parents of the individual; v) any lineal ascendant or descendant of the individual; vi) any lineal ascendant or descendant of the spouse of the individual; vii) the spouse of the person referred to in (ii) to (vi) above.

c. Recharacterisation of a step, or a part of the whole of the transaction

The GAAR applies to any *"any step in or a part of the arrangement as they are applicable to the arrangement". (Explanation to section 95 of ITA).* An arrangement as mentioned earlier means any step in or a part or the whole of any transaction, operation, or scheme. In a tax-avoidance arrangement, a transaction is artificially broken into a number of successive acts, conceived from the outset as forming a part of an inseparable chain. Thus, under the provisions of the GAAR, the revenue authorities have been given the power to alter the transaction on the basis of a legal characterisation that is given to each of the legal acts taken separately by disregarding, combining or recharacterising a part or the whole of it. It is not necessary for the entire arrangement and all the steps to be disregarded or recharacterised.

Characterisation of income

The basis for identifying an impermissible avoidance arrangement is to identify the transaction actually undertaken, i.e. its nature and structure. Nature is the characterisation and structure is the form. The characterisation and the form of the transaction actually undertaken by the parties may not be disturbed, except in exceptional circumstances. Income is determined on the basis of the transaction as structured by the parties. But in some cases, such a structure is not bona fide. In other words, independent parties would not have acted in similar manner. Independent parties would not have agreed to the structure in which the economic substance differs from the form or when, the form and substance being the same, the agreement behind the transaction is different.

The revenue authority may recharacterise or restructure the transaction according to the substance. The structure adopted by the taxpayer can be disregarded if the economic substance differs from its form. Furthermore, even the place of residence of any party to the arrangement or situs of an asset or transaction may be treated as being at a place different from the place of residence or location as provided in the arrangement.

"Determination" of tax consequences

Section 98(1) provides for the determination of tax consequences after an arrangement has been declared to be an impermissible tax avoidance arrangement. The determination is to be carried out in a manner befitting to the circumstances of the case. Statutory guidelines for the possible treatment have been provided.

In conclusion, the application of the GAAR involves three steps. It must be determined:

a) whether the main purpose of the arrangement is to obtain a tax benefit;
b) whether the transaction is an avoidance transaction in the sense of lacking commercial substance or not being arranged primarily for bona fide purposes; and
c) whether there was a misuse or abuse of the provisions of the Act, in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied on by the taxpayer.

The determination of the existence of a tax benefit and an avoidance transaction involves a factual decision. The burden of proof has been placed with the taxpayer because he is presumably in the best position to know the facts of his case. It is similar to any tax proceeding in which the taxpayer disputes the Revenue's assessment and its underlying assumption of facts. The initial obligation lies with the taxpayer to refute the Revenue's factual assumptions by contesting the benefit or by showing a bona fide, non-tax purpose that primarily drove the transaction. Presumption alone, without any basis, is not sufficient to establish tax avoidance.

Burden of proof

Under the law, the burden of proof rests with the taxpayer to establish that the tax benefit was not the main purpose of the arrangement. The other genuine purposes could be, amongst many others, a restructuring of the business or other commercial decisions. The analysis of these purposes would have to tested against the tax benefit obtained in order to determine the "main purpose" of the arrangement.

The GAAR Framework under the Income Tax Rules

The framework of the Income Tax Rules governing the GAAR provisions is tabulated below.

Rule 10U	Chapter X-A not to apply in certain cases
Rule 10UA	Determination of the consequences of an impermissible avoidance arrangement
Rule 10UB	Notice, Forms for reference under section 144BA
Rule 10UC	Time Limits

Rule 10U – Rule 10UC of the Income Tax Rules, 1962 ('the Rules') provides cases to which the provisions of chapter X-A would not be applicable. These cases are discussed below.

The provisions of Chapter X-A of the Act shall not apply to an arrangement in which the *tax benefit in the relevant assessment year* arising, *in aggregate, to all the parties to the arrangement* does not exceed a sum of INR 30 million. The Shome Committee had recommended the prescription of a high threshold for applying the GAAR to capture only highly sophisticated structures. The report stated that a tax benefit should be more than a specified amount; the benefit should arise to the taxpayer involved and the benefit should be in the income year involved.

Rule 10U (3) (iv) of the Rules provides that, for the purpose of this rule, 'tax benefit' as defined in section 102(10) and computed in accordance with Chapter X-A shall refer to

i) sub-clauses (a) to (e) of the said clause, the amount of tax; and
ii) 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.

As discussed above, a tax benefit has been defined with respect to tax or another amount payable under the Act. However, Rule 10U seeks to restrict the scope of a tax benefit to the amount of tax only and does not refer to another amount payable. The Shome Committee in its report had recommended that, for the sake of clarity, it may be specified that a tax benefit, for the purposes of the threshold, shall include only income tax, dividend distribution tax and profit distribution tax, and shall not include other amounts such as interest, income, etc.

The threshold of the tax benefit of INR 30 million is applicable for a particular assessment year. Thus, an arrangement may result in a tax benefit of INR 20 million in year 1 and INR 15 million in year 2. While the aggregate tax benefit arising to the assessee is INR 35 million, the tax benefit in a particular assessment year is below the stipulated threshold of INR 30 million. It may be noted that the definition of 'tax benefit' under section 102(10) of the Act refers to a tax benefit in the relevant previous year and therefore the GAAR would not be triggered.

As per Rule 10U (1) (a), the provisions of Chapter X-A *shall not apply to an arrangement* if the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed INR 30 million. The threshold of the tax benefit of INR 30 million is to be computed on an overall basis for all parties to arrangement taken together.

In its Circular no. 7 dated 27 January 2017, the Central Board of Direct Taxes (CBDT) has provided clarification on the computation of a tax benefit if tax consequences extend across jurisdictions. The CBDT has clarified that the application of tax laws is jurisdiction-specific and hence what can be seen and examined is the 'tax benefit' enjoyed in the Indian jurisdiction due to the arrangement or part of the arrangement. Thus, if an arrangement results

in a tax benefit for an assessee in an overseas jurisdiction, the same should not be included for computing the limit of INR 30 million in order to determine applicability of Chapter X-A.

The term 'tax benefit' also means a deferral of tax. In cases in which an arrangement results in a tax benefit in the form of a deferral of tax, an issue that could have been considered was how the amount of the tax benefit would be computed. In cases involving a tax deferral, the only benefit to the taxpayer is not paying tax in one year, but rather paying it in a later year. Overall, there may not be any tax benefit, but the benefit exists in terms of the present value of money. In its report, the Shome Committee had recommended that "*In case of a tax deferral, the tax benefit shall be determined based on the present value of money*".

Nothing is specifically stated in the law or in the rules on the GAAR, but the law as it is can be read to suggest that the full tax benefit would be considered in the year when it arises or when it stands deferred to another year.

Rule 10 U (1) (a) restricts the applicability of Chapter X-A to arrangements that result in a tax benefit of more than INR 30 million. The threshold laid down in the law could have been taken on administrative grounds, so that the Revenue looks only at bigger cases. Also, once a specific GAAR is introduced in the statute, no judicial GAAR would apply to cases below the threshold limit laid down. It has further been clarified by the Government that, "*the GAAR pertains to an arrangement or a part of an arrangement, and therefore a limit of INR 30 million cannot be read in respect of a single taxpayer only.*"

2. Case law on statutory or court-developed GAARs

In the Indian context, the statutory GAAR is a new-born concept. The courts have therefore not had an occasion to interpret the tax-avoidance law and rules.

2.1. General overview

As already stated, the provisions of the GAAR took effect on 1 April 2017. How the new provisions will be implemented by the Tax Department is yet to be seen. In the past, the courts have been engaged with the question of what tax avoidance is. The tribunals and the courts have largely answered this question by interpreting the written law and ascertaining whether or not there is an anti-avoidance provision in the domestic law and or a Limitation of Benefits article in the treaty. At times, the substance-over-form has been upheld, allowing the 'piercing of the corporate veil'. A few recent decisions are discussed below:

JSH (Mauritius) Ltd. [TS-308-HC-2017 (Bom)]

The Authority for Advance Ruling (AAR) held that capital gains arising to JSH (Mauritius) Ltd. (assessee) in respect of a transfer of shares in Tata Industries Limited ('TIL') to Tata Sons Limited ('TSL') is not taxable in India in view of article 13 of the India-Mauritius DTAA. The Revenue filed an appeal with the High Court. The Revenue's stand was that the assessee is a mere shell company and has no business or commercial substance because it never nominated anyone to the Board of TIL at any point in time and it never incurred expenses for wages, the salaries of staff, electricity, water and telephone charges, rent, or directors' emoluments. HC observed that the assessee holds a Category 1 Global Business License

issued by the Financial Services Authority of Mauritius and has also been issued a tax residency certificate ('TRC'). Further noting that the assessee held the shares for 13 years, HC remarked that, "*This goes to suggest the bona fide of the applicant.*" Upholding AAR's decision, the Court held that, while considering the factual matrix of the matter, the AAR had perversely not recorded any finding. Rejecting the Revenue's arguments on the transaction being taxable u/s amended Sec. 9 (i) (i) & Explanation 5, the High Court cited the Supreme Court ruling in Azadi Bachao Andolan & Anr[18] wherein the Court observed that the terms and conditions of the DTAA would prevail even if they were inconsistent with Income Tax Act provisions. The High Court in this case relied on the form of TRC and Global Business License being available, and also on the fact that the shares were held by the same entity for 13 years.

In the above context, Chapter X-A relating to the GAAR clarifies that the period of time for which the arrangement exists may be relevant, but not sufficient for determining whether an arrangement lacks commercial substance. The (i) fact of the payment of taxes, directly or indirectly, and the (i) fact that an exit route is provided by the arrangement also have been incorporated into the statute as relevant, but not sufficient for determining whether an arrangement lacks commercial substance.

Emerald Jewel Industry India Ltd. [TS-573-ITAT-2016(CHNY)]

The Chennai Income Tax Appellate Tribunal allowed a depreciation claim, u/s 32 of the ITA for AY 2011-12, on brand 'Ishtaa' acquired by the assesse (who was engaged in the manufacturing and sale of gold and diamond jewellery) from its associate company in 2009 despite the subsequent amalgamation of the associate company with the assesse with effect from 31 December 2009. The Revenue had argued that since the associate company itself was amalgamated, subsequently resulting in the transfer of all assets (including intangibles), there was no requirement for the assessee to purchase the brand separately. It was argued that a claim of depreciation was a colourable device. Rejecting the Revenue's position, the ITAT observed that the brand was acquired by the assesse prior to amalgamation and furthermore the assessee made the payment through a banking channel to acquire the brand. It was accordingly opined that the assessee was eligible for depreciation as claimed. Further noting that the associate company was a loss-making company, the ITAT clarified that "*mere claiming set off of loss suffered by the amalgamated company cannot be a reason to disallow the claim of the assessee for depreciation*."

Abhinandan Investments Ltd. [TS-666-HC-2015 (DEL)]

The High Court (HC) reversed the ITAT's order and held that the transaction of a renunciation of rights to subscribe to partly convertible debentures ('PCDs') of JISCO (a Jindal Group company) during AY 1992-93 was a colourable device contrived to create an artificial loss. The facts are that the assessee (a Jindal group company) renounced rights in PCDs in favour of another group company ('JSL') at a significantly lower price than the market value, resulting in significant loss. The HC denied the assessee's loss set-off claim and held it to be only a notional loss. It took note of the peculiar facts whereby the assessee sold JSL shares

[18] Union of India and Anr. vs Azadi Bachao Andolan And Anr. [2003].

during relevant year, resulting in substantial capital gains, and at the same time undertook a transaction of renunciation of rights which resulted in huge losses. HC opined that "*In order to avoid paying the tax, the investment companies, including the Assessee, entered into transactions for renunciation of rights with related companies of the same group. These incestuous transactions were for no other business purpose but to contrive a loss in the hands of assessee who had incurred a tax liability on account of the gains made.*" The HC noted observations of Justice Chinnappa Reddy in the McDowell ruling and quoted Justice Ranganath Misra's observation as speaking for the majority, that "*tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be a part of tax planning ...*" The HC pointed out that, in the Vodafone ruling, SC had held that the opinion of Justice Chinnappa Reddy must be read in conjunction with the observation of Justice Ranganath Misra (i.e. the majority opinion in the McDowell case). Furthermore, it cited the SC ruling in Azadi Bachao Andolan and concluded that "*in order to examine whether a transaction is a device or a subterfuge, the answer to the question whether the transaction has any reasonable business purpose would be a vital consideration*". The HC holds that the transactions were implemented in this case by the assessee for no commercial purpose other than to create a tax loss while, at the same time, ensuring that rights remained within the Jindal Group. The HC concluded that "*This would be an abuse of the corporate form and such transactions, even though implemented, cannot be considered to be other than a colourable device for avoidance of tax*". In addition, with respect to gains arising from the sale of JSL shares, the HC rejected the taxpayer's position of assessing it as capital gains, and held that the shares had been retained as a trader and not as an investor and therefore, as a consequence, the gains would be taxed as income from business.

3. GAAR and taxpayer's safeguards

The introduction of the GAAR provisions and its application as from 1 April 2017 had been perceived by some stakeholders as creating unpredictability for business. This has been addressed by the Government through well-thought-out safeguards that have been incorporated in tax law. Such provisions were not there in the law as originally introduced. In India, the tax officer who conducts an assessment or audit of a taxpayer is known as the Assessing Officer (AO). In the determination of the total income of a taxpayer, the AO may, if he considers it necessary, propose to declare an arrangement as an impermissible avoidance arrangement and also to determine the consequence of such an arrangement. The AO would have to make a reference of such a proposal to the Commissioner or Principal Chief Commissioner of Income Tax, who would, on being satisfied that the GAAR applies, issue a notice to the taxpayer to submit his objections. When the Commissioner/Principal Commissioner is satisfied that the provisions of the GAAR are not to be invoked, then he would intimate this decision to the AO and the taxpayer, and the matter raised by the AO would be closed. When the taxpayer files objections and the Commissioner, after a hearing, is of the opinion that the provisions of the GAAR apply, then he would have to refer the case to an Approving Panel. After providing an opportunity to the AO and the taxpayer to speak, the Panel would issue directions on whether the GAAR applies or not. No appeal can be made against the directions issued by the Approving Panel and their decision is binding on both the taxpayer and the Tax Department. The Chairperson of the Approving Panel shall be a person who is or has been a judge of the High Court. There are, therefore, two levels at which the application of the GAAR would be tested, i.e. at the Principal Commissioner's and, if necessary, finally by a panel headed by a judge of a High Court. The above-mentioned

process pre-empts the GAAR provisions from being applied indiscriminately by the Tax Department.

In addition to the safeguards, the Government has also clarified that grandfathering is available under the General Anti-Avoidance Rules. Investments made into India prior to 1 April 2017 have been therefore protected from the application of the GAAR. It has been clarified that in respect of instruments compulsorily convertible from one form to another under terms finalised earlier, i.e. at the time of issue of such instruments, would be protected from the application of avoidance rules. Furthermore, shares brought into existence by bonus issuances in respect of shares acquired prior to 1 April 2017 in the hands of the same investor would also be eligible for grandfathering under the Rules. The term 'investments' has also been clarified by Government to cover all forms of investments. It has also been made clear that, if the Principal CIT/ Approving Panel has held an arrangement to be permissible in one year, then following the principle of consistency, the GAAR would not be invoked in a subsequent year if the same set of facts and circumstances prevail.

Conclusion

It is the duty of each and every citizen to pay taxes in accordance with the tax laws. The intent of existing and future laws must be available in detail and should be in the public domain so that there is little room for the 'abuse' of the provisions of the ITA and the DTAAs. To what extent tax planning would be allowed and when it would be deemed tax avoidance would probably still have to be interpreted by the courts and their earlier decisions in this regard may prevail. As to what would prevail – the specific avoidance measure in the ITA or the GAAR remains to be answered, particularly when the situation of a case falls entirely within the scope of the SAAR provisions. It could be interpreted that the GAAR, as law introduced later, has now replaced SAARs. GAAR and SAAR is expected to continue together, as the latter may not address all situations of misuse of the law and the Government cannot be expected to address each new scheme of tax avoidance as and when it is noticed. The CBDT has clarified that, if the Limitation of Benefits (LOB) article and the Principal Purpose Test (PPT) in the Multilateral Instrument (MLI) are not sufficient to tackle tax-avoidance strategies, then the GAAR could still be invoked. In fact, when countries have opted to apply only the PPT rule whereas India has decided to follow the LOB and the PPT under the MLI, there may be a mismatch, and the GAAR may address the concerns of the Tax Department. The introduction of the GAAR in the statute may ease the task of the judiciary in deciding on tax-avoidance cases because the provisions categorically lay down the concepts of an impermissible avoidance arrangement, a lack of commercial substance, the use of an accommodating party, round-trip financing and tax benefit. An important aspect which shall be the front-runner in GAAR's effective implementation in India will be the composition and autonomy of the GAAR Approving Panel. In the Indian context, the GAAR provisions have not seen the light of day in a very real sense. While the burden of proof lies with the taxpayer on the application of the GAAR, the onus is on the Revenue to use this tool effectively and not indiscriminately.

Judge Earl Warren very aptly said – "*It is the spirit and not the form of law that keeps justice alive*".

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