General Anti Avoidance (GAAR)



Tax Planning, Tax Avoidance & Tax Evasion





Tax planning may be defined as arrangement of one's financial affairs in such a way that, without violating in any way the legal provisions, advantage is taken of all tax exemptions & deductions, permitted under the Act so to minimize burden the taxation.

Examples:

- i Choosing the suitable form of assessable entity (individual, firm, company)
- ii Choosing suitable forms of investment (share capital, loan capital, lease) considering deductions available in respect of interest, exemption available in respect of dividend etc.
- iii Diversification of the business activities considering the various profit-linked benefits





Tax evasion refers to any attempt to avoid payment of taxes by using illegal means.

Examples:

- i misrepresentation or suppression of facts;
- ii failure to record investments in books of account;
- iii claim of expenditure not substantiated by any evidence;
- iv recording of any false entry in books of account;





TOTALLY LEGAL. TOTALLY WRONG.



Minimization of one's tax liability by taking advantage of legally available tax planning opportunities.

Tax avoidance may be contrasted with evasion, which entails the reduction of tax liability by using illegal means.

[Black's Law Dictionary]
The arrangement is entered into solely or primarily for the purpose of obtaining a tax advantage & does not have any commercial substance.

Example:

If a person shift his existing business to a SEZ just to claim the tax benefits u/s 10AA & there is no other commercial consideration involved.

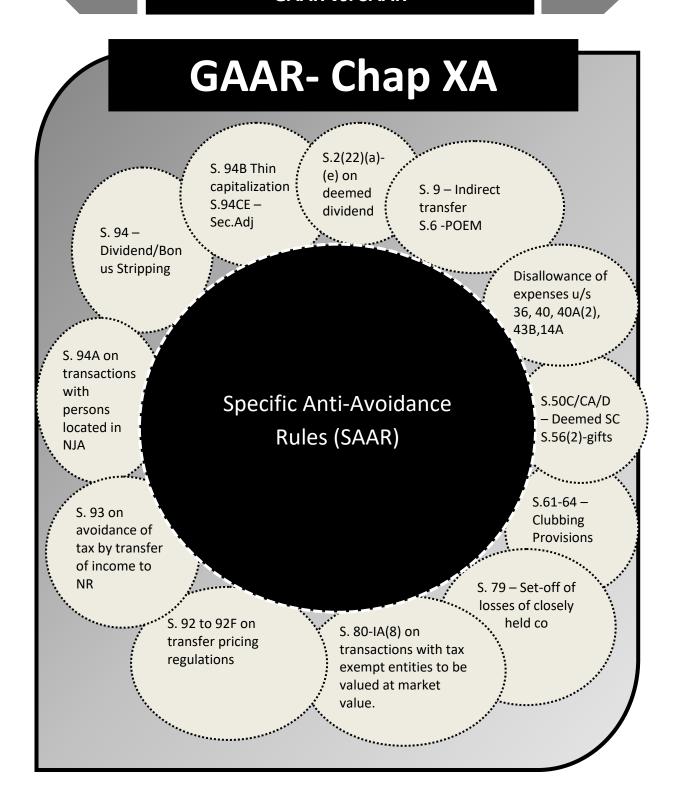
UK SC in the matter of Duke of Westminster 1936 famously expounded that Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Act is less than otherwise would be thereby accepting aggressive tax planning.

In CIT vs. A Raman, Westminister Principle was followed. It was held that effectiveness of the device depends not upon consideration of morality but on the operation of the Income-tax Act, 1961.

In Mcdowell case it was held that tax planning may be legitimate provided it is within the framework of law Colorable devices cannot be a part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods.

Particulars	Whether GAAR applicable
Tax Mitigation/Tax Planning - involves legal	☑- This is permissible
measures with substance to save	
Taxes	
Eg: Setting up of unit in SEZ to claim	
exemption u/s 10AA	
Tax evasion - where the transactions	☑- as existing jurisprudence
are outright sham, or are concealed	is sufficient to cover tax evasion / sham
Eg: diversion of production from non-SEZ	transactions.
unit to SEZ unit just to claim exemption u/s	
10AA	
tax avoidance with the use of legal steps	☑- Covered by GAAR
resulting in tax reduction, which steps would	
not have been undertaken	
if there was no tax reduction	

GAAR vs. SAAR



Will GAAR be invoked if SAAR applies?

CBDT has stated that 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.

Will GAAR be applied to deny treaty eligibility in a case where there is compliance with Limitation of Benefit (LOB) test of the treaty?

CBDT has clarified that 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.



The GAAR provisions were introduced in the Income-tax Act, 1961 vide the Finance Act, 2012 by insertion of new Chapter X-A. Chapter X-A was substituted by the Finance Act, 2013.

The Government subsequently set up a panel under Parthasarathy Shome to review the proposals. The Committee suggested that the rules be deferred by three years to 2016-17, arguing that more time is needed to create administrative machinery for its implementation and called for intensive training of officials.

The Shome Committee Report explains the need for and rationale of GAAR as under:

- i. The GAAR provisions codify this 'substance over form' basis of the tax law.
- ii. Transactions have to be real and are not to be looked at in isolation.
- iii. The fact that the transactions are legal, does not imply that they are acceptable with reference to the underlying meaning embedded in the fiscal statute.
- iv. Thus, where there is no business purpose except to obtain a tax benefit, the GAAR provisions would not allow such a tax benefit to be availed through the tax statute.

The CBDT, vide Press Release dated January 27, 2017, clarified that the GAAR provisions shall be effective from A.Y.2018-19 onwards, i.e., financial year 2017-18 onwards. The provisions of GAAR are contained in Chapter X-A of the Income-tax Act, 1961. The necessary procedures for application of GAAR and conditions under which it shall not apply, have been enumerated in Rules 10U to 10UC of the Income-tax Rules, 1962.

GAAR Codified [Chapter XA]

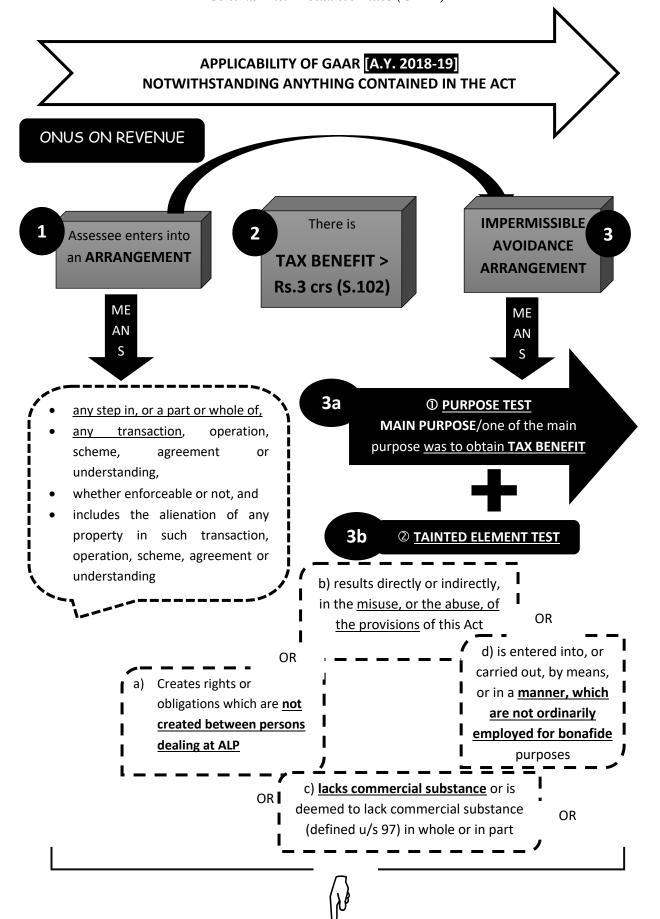
90(2A)	GAAR overrides treaty
95	Applicability of GAAR

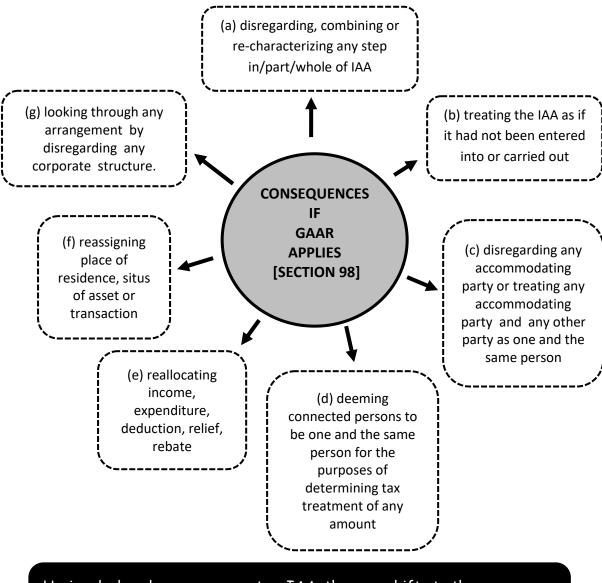
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96	Impermissible Avoidance Arrangement ("IAA")
97	Arrangement of lack commercial substance
98	Consequences of IAA
99	Treatment of connected person and
	accommodating party
100	Application of Chapter X-A
101	Chapter X-A to be applied in accordance with
	guidelines to be framed
102	Definitions
144BA	Administration of GAAR
Rule 10U	Exclusions from applicability of Chapter X-A



Section 90(2A): GAAR Overrides Treaty

Notwithstanding anything contained in section 90(2), the provision of chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.





Having declared an arrangement as IAA, the onus shifts to the assessee to rebut the

declaration or agree with the revenue's view.

Analysis of GAAR

Analysis of the above provision:

- 1. Section 95 of the Act with regard to the applicability of GAAR provides that <u>an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement</u> and the consequence in relation to tax arising there from may be determined subject to the provisions of this Chapter.
- 2. The term arrangement is defined u/s 102 and the term impermissible avoidance arrangement is defined u/s 96.
- 3. The section further clarifies that the provisions of this Chapter may be applied to any

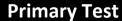
step in, or a part of, the arrangement as they are applicable to the arrangement.

4. The section starts with a non-obstante clause which means, if there is a conflict with provisions in other sections, then this section shall prevail over other conflicting provisions.

Impermissible Avoidance Arrangement

For declaring an agreement as an impermissible avoidance arrangement, twin conditions needs to be satisfied:

- a) <u>Purpose test:</u> The purpose test requires that the main purpose or one of the main purposes is to obtain tax benefit. The term "tax benefit" has been defined in section 102. The onus of establishing that the main purpose is to obtain a tax benefit is on the tax authority.
- **b)** <u>Secondary test:</u> Any of the 4 secondary test needs to be satisfied for invoking GAAR which are discussed in detail below.



The purpose test requires that the main purpose or one of the main purposes is to obtain tax benefit.

Example:

Company A is in the business of manufacturing soaps. Company B is in the business of manufacturing caustic soda (a raw material for soaps). Both are independent companies. For having in-house raw material supplies, it was agreed between the companies that Company B will merge with Company A. This also results in tax savings on account of capital gains; getting access to funds of Company B, etc. Company A could also have bought out the assets of Company B. However merger was agreed upon as there would be no tax. In this illustration, business reason was one of the main reasons for merger. Tax benefit was also an important reason but not one of the main purposes. In this situation, GAAR cannot apply.

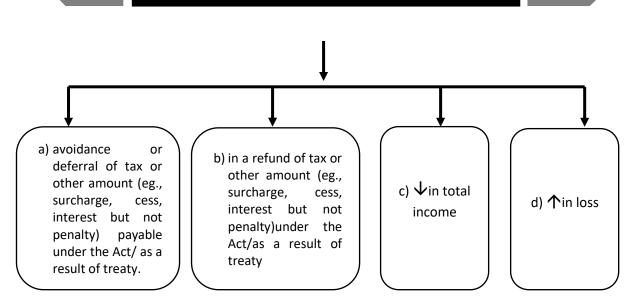
Example:

Consider a similar situation but where Company B is a subsidiary of Company A. Here Company A already has access to raw material of Company B (being its subsidiary). If Company B merges with Company A, will tax benefit be considered as the main purpose or one of the main purposes? In this case, the chances of applicability of GAAR are higher.

CBDT has clarified that GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

The illustration is of returning funds to the shareholder by way of dividend or buyback of shares. Both are legitimate ways of returning funds to shareholders. Just because a particular manner of returning funds to the shareholder reduces tax, it does not mean GAAR should apply. In essence commercial substance has to be satisfied so that GAAR may not apply.

Section 102: Tax Benefit



The revenue will have to "re-arrange" the facts and arrive at reworked facts. These are known as counter-factuals. The tax will be worked out based on reworked facts. The difference between tax on reworked facts and assessee's facts will be tax benefit. The revenue will have to rework the facts and compute the tax benefit before a notice is issued to the assessee.

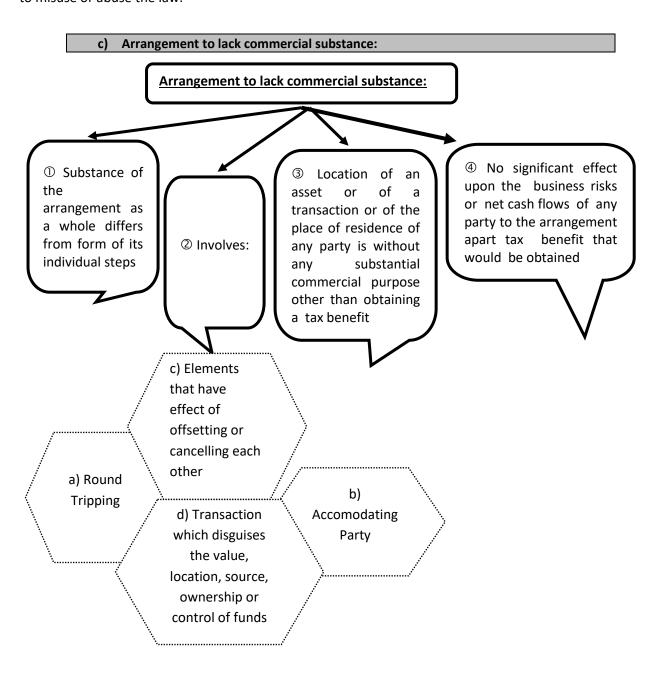
Secondary Test

a) Creates rights or obligation which are not created between person dealing at ALP.

As there are specific transfer pricing regulations (SAAR) applicable to international transactions, this tainted element is to be examined only in those transactions <u>which are not covered by Transfer Pricing regulations</u> and where the main purpose of the arrangement is to obtain tax benefit.

b) Results directly or indirectly, in the misuse, or the abuse, of the provisions of this Act

It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.



① Substance of the arrangement as a whole differs from form of its individual steps:

It implies that where substance of an arrangement is different from what is intended to be shown by the form of the arrangement, then tax consequence of a particular arrangement should be assessed based on the —substance of what took place. In other words, it reflects the inherent ability of the law to remove the corporate veil and look beyond form.

② a) Round Tripping

Round trip finance has been explained in S.97(2). It includes an arrangement in which through a series of transactions:

- funds are transferred amongst parties to an arrangement, and
- transactions do not have any substantial commercial purpose.

Normally, Round trip finance is a situation where funds are sent abroad by hawala channel, and these return as official money to India as export sales, foreign investment, loans, etc. This is largely black money.

Further there is no need for funds to return to the same location from where the same were sent. Nor it is necessary for the funds to return to the person or persons in the group who sent the funds.

Will GAAR provisions apply where the jurisdiction of the Foreign Portfolio Investors (FPI) is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees

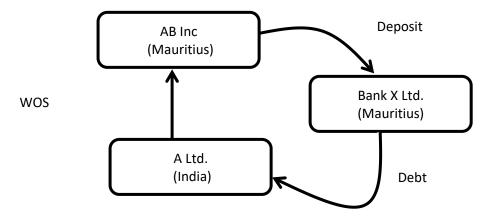
For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient 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.

2b) Accommodating Party

An accommodating party is one which facilitates the transaction for the assessee in a tax efficient manner & the only purpose is to facilitate the tax efficient transaction. Therefore, it is provided that an arrangement with an accommodating party will be deemed to lack commercial substance if the main purpose of direct or indirect participation of that party in an arrangement (whole or part) is to obtain a tax benefit for the assessee.

It is not necessary that the accommodating party is a connected party or not. If there is an accommodating party or a connected person, then such persons can be ignored and the transaction can be considered to have been undertaken by the assessee itself.

②d) Transaction which disguises the value, location, source, ownership or control of funds



- (i) X Ltd. is a banking institution in Mauritius- LTJ (Low Tax Jurisdiction);
- (ii) There is a closely held company AB Inc in LTJ which is a wholly owned subsidiary of another closely held Indian company DS Ltd.
- (iii) AB Inc has reserves and, if it provides a loan to A Ltd., it may be treated as deemed dividend under section 2(22)(e) of the Act.
- (iv) Therefore, AB Inc makes a term deposit with X bank Ltd. and X bank Ltd., on the basis of this security, provides a back to back loan to A Ltd.

Say, India-Mauritius tax treaty provides that interest payment to a Mauritian banking company is not taxable in India.

Can GAAR be invoked?

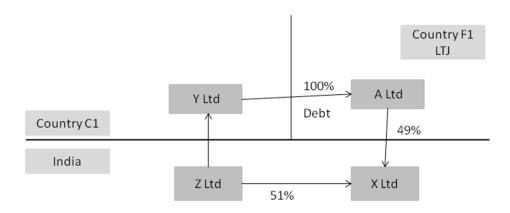
YES

- 1. This is an arrangement whose main purpose is to bring money out of reserves in AB Inc. to India without payment of due taxes.
- The tax benefit is saving of taxes on income to be received from AB Inc. by way of dividend or deemed dividend.
- 3. The arrangement disguises the source of funds by routing it through X bank Ltd. X bank Ltd. may also be treated as an accommodating party. Hence, the arrangement shall be deemed to lack commercial substance.
- 4. Consequently, in the case of A Ltd., the loan amount would be treated as dividend income received from AB Inc to the extent reserves are available with AB Inc. and no expense by way of interest would be allowed.
- 5. In the case of X bank Ltd, exemption from tax on interest under the DTAA may not be allowed as X Ltd. is not a beneficial owner of the interest, provided the DTAA has antiavoidance rule of beneficial ownership.
- If such anti-avoidance rule is absent in DTAA, then GAAR may be invoked to deny treaty benefit as arrangement will be perceived as an attempt to hide the source of funds of SS Inc.

Example:

A Discretionary Trust in UK has UK professional trustees. It invests in India and gets relief under the India- UK DTA. The trust is actually controlled by the Hong Kong resident and he is the beneficiary of the trust income. The owner is being disguised. This transaction will be considered as tainted.

> 3 Location of an asset or of a transaction or of the place of residence of any party is without any substantial commercial purpose other than obtaining a tax benefit



- (i) Y Ltd. is a company incorporated in UK. It is a non-resident in India.
- (ii) Z Ltd. is a company resident in India.
- (iii) A Ltd. is a company incorporated in Mauritius and it is a 100% subsidiary of Y Ltd.
- (iv) A Ltd. and Z Ltd. form a joint venture company X Ltd. in India after the date of commencement of GAAR provisions. There is no other activity in A Ltd.
- (v) The India-Mauritius tax treaty provides for non-taxation of capital gains in the source country and Mauritius charges no capital gains tax in its domestic law.
- (vi) A Ltd. is also designated as a permitted transferee of Y Ltd. Permitted transferee means that though shares are held by A Ltd, all rights of voting, management, right sell etc., are vested in Y Ltd.
- (vii) As per the joint venture agreement, 49% of X Ltd's equity is allotted to A Ltd. and 51% is allotted to Z Ltd.

YES

- 1. The arrangement of routing investment through Mauritius results in a tax benefit. Since there is no business purpose in incorporating company A Ltd. in Mauritius which is a Low Tax Jurisdiction (LTJ), it can be said that the main purpose of the arrangement is to obtain a tax benefit.
- 2. The alternate course available in this case is direct investment in X Ltd. joint venture by Y Ltd.
- 3. The tax benefit would be the difference in tax liabilities between the two available courses.
- 4. The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating A Ltd. as it does not have any effect on the business risk of Y Ltd. or cash flow of Y Ltd. As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked.
- 5. Additionally, as all rights of shareholders of X Ltd. are being exercised by Y Ltd instead of A Ltd, it again shows that A Ltd lacks commercial substance.

(viii) Thereafter, the shares of X Ltd. held by A | Hence, unless it is a case where Circular 789

Ltd. are sold to C Ltd., a company connected to the Z Ltd. group.	relating to Tax Residence Certificate in the case of Mauritius, or Limitation of Benefits clause in
As per the tax treaty with Mauritius, capital gains arising to A Ltd. are not taxable in India.	India-Mauritius treaty is applicable, GAAR can be invoked.
Will GAAR apply ?	

Illustration - Mr. A is an Indian resident. He is expecting substantial gain from sale of his foreign assets. He becomes a non-resident, sells the foreign assets, and then returns to India. Here residence of Mr. A is involved. If there is no commercial purpose for Mr. A to become a non-resident, it will be considered as a tainted transaction.

Clarification of CBDT on GAAR

CBDT has clarified that

- (1) Threshold of Rs. 3 crores in respect of tax benefit in a relevant assessment year arising in aggregate to all parties to the arrangement.
- (2) GAAR not to apply to Foreign Institutional Investors ("FII") subject to satisfaction of certain conditions.
- (3) As per the new GAAR notification by CBDT, the investments made before 1st April 2017 will be grandfathered.
- (4) 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.

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?

CBDT has clarified that if the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow

It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.

CBDT has clarified that adequate procedural safeguards are in place to ensure that GAAR is invoked in uniform, fair and rational а In the event of a particular manner. consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding adjustments across different taxpayers could militate against deterrence.

Tax benefit of INR 3 crores may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).

CBDT has clarified that the application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of Rs. 3 crores cannot be read in respect of a single taxpayer only.

Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?

CBDT has clarified that if the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.

Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.

CBDT has clarified that GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as 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.

Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Compulsorily Debentures, Convertible Preference Shares (CCPS), Foreign Currency Convertible **Bonds** (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up consolidation grandfathered of such shareholding?

Grandfathering will be 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. 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 in the hands of the same investor would also be eligible for grandfathering.

However, Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. 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 arrangements are, by themselves, not 'investments' and hence grandfathering is not available.

Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?

Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.

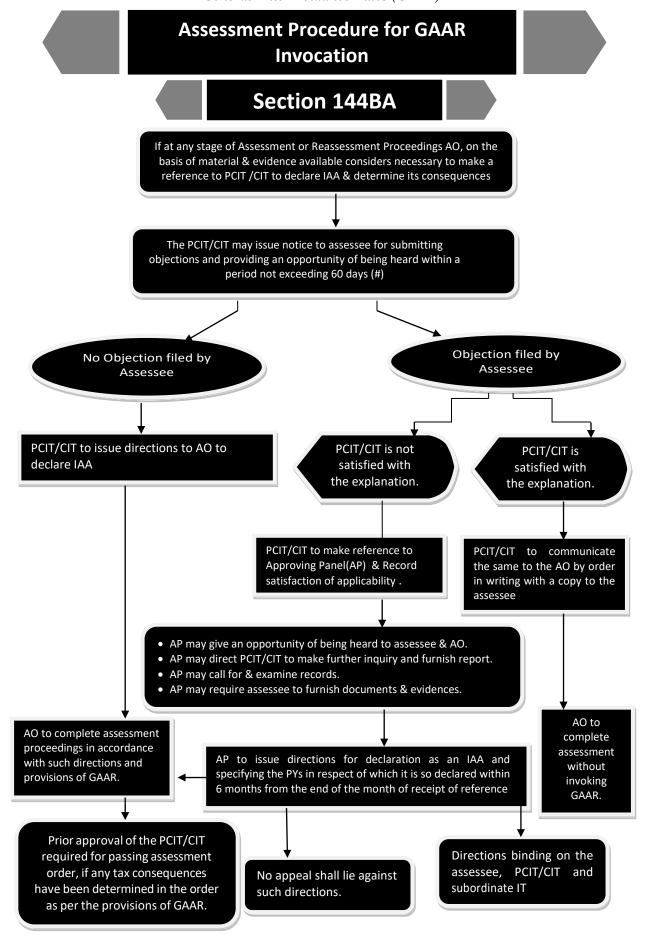
Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?

No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.

No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.

Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available

under law. The assessee, may at his option,
apply for benefit u/s 273A if he satisfies
conditions prescribed therein.



# The	# The following period has to be excluded in computing the said period:		
(i)	The period commencing from the date on which the first direction is issued by the		
	Approving Panel to the Principal Commissioner or the Commissioner for getting		
	inquiries conducted through the authority competent under an agreement referred to		
	in section 90 or section 90A and ending with the date on which the information so		
	requested is last received by the Approving Panel or one year, whichever is less.		
(ii)	The period during which the proceeding of the Approving Panel is stayed by an order or		
	injunction of any court.		

Note – If, immediately after the exclusion of the aforesaid time or period, the period available to the Approving Panel for issue of directions is less than 60 days, such remaining period shall be extended to 60 days. Consequently, the aforesaid period of six months shall be deemed to have been extended accordingly.

Approving Panel

	Particulars	Provisions	
(1)	Constitution	The Central Government may constitute one or more Approving Panels	
		as may be necessary	
(2)	Composition	Each Approving Panel may shall consist of three members including a Chairperson	
(3)	Qualification of members	(i) The Chairman shall be a person who has been a judge of a High Court	
		(ii) One member shall be a member of IRS not below the rank of PCC/CCIT	
		(iii) One member shall be an academic or scholar having special knowledge of matters, such as direct taxes, business accounts and international trade practices.	
(4)	Term	Ordinarily for one year; May be extended from time to time upto a period of three years.	
(5)	Frequency of Meeting	The Chairperson and members of the Approving Panel shall meet, as and when required, to consider the references made to the Panel. They shall be paid the remuneration as may be prescribed.	
(6)	Powers	(i) The Approving Panel has to issue such directions, as it deems fit, in respect of declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying the previous year or years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.	
		(ii) The Approving Panel, may, before issuing any direction under section 144BA(6), if it is of the opinion that any further inquiry in the matter is necessary, direct the PC/C to make such inquiry or cause the inquiry to be made by any other IT authority and furnish a report containing the result of such inquiry to it.	
		(iii) Call for and examine such records relating to the matter as it deems fit.	

		(iv)	Require the assessee to furnish such documents and evidence as it may direct
		(v)	All the powers which are the vested in the AAR u/s 245U
(7)	Officers	The CBDT shall provide to the Approving Panel such officials as may be necessary for the efficient exercise of powers and discharge of functions of the Approving Panel under the Income-tax Act, 1961.	
(8)	Rules	The CBDT may make rules for the purpose of the constitution and efficient functioning of the Approving Panel and expeditious disposal of the references received.	