

**B S R and Company**

# **General Anti Avoidance Rules**

**FICCI**

**06 October 2012**



# Indian Economic Scenario

- Indian economy - going through one of its toughest phases with GDP plunging to nearly a decade low
- Ongoing struggle against the twin deficit syndrome – current account and fiscal deficit
- Inflation on a relentless increase; High interest rates taking a toll on industrial activity and investor's sentiment
- Measures chalked out to insulate India against global recessionary environment
- 'Big ticket reforms' launched amidst political opposition in multi-brand retail, aviation, broadcast, insurance and pension sectors to attract FDI
- Tax Climate in the investing jurisdiction – critical determinant for inbound investment
- Capital punishment for capital investment ? – Vodafone concerns echoed amidst retro amendments
- GAAR, albeit a common counter-tax avoidance measure in developing countries – a radical change in Indian tax regime
- India competing with other Asian markets to attract global capital investment, while ushering concerns on tax administration

**GDP**  
**FY 2011-12 - 6.9%**  
**Current Forecast - 5.5%**

**Stakeholder's expectations – A  
stable tax regime!**

# GAAR : Influence on investment flows

**Constitution of Expert Committee with independent members – Investors Repose faith in tax administration : Judge and Jury – Different**

**Expert Committee Recommendations - Winning back investor confidence**

Abolishment of tax on gains arising from transfer of listed securities *de hors* of its nature both for residents and non-residents

Where FII does not avail treaty benefit and is subject to tax under the Act, GAAR not to apply

GAAR not to apply to non-residents investing directly or indirectly through FIIs' in Indian listed securities

**Relief for P-note holders ?!**

**FII investment witnesses one of the year's highest in Sep 2012 (Rs. 20,769 crores)  
In light of GAAR deferment Buzz?**

**Value of INR witnessing an increasing trend**

- August - 1 USD = INR 55.53
- September - 1 USD = INR 54.47
- Current - 1 USD = INR 51.85

# GAAR : Headline Apprehensions

GAAR provisions are creating a very nervous situation for foreign investors at a time when India really needs their participation" - Nicholas de Boursac, CEO of ASIFMA

Only after the Government can assure a transparent, non-corrupt and fair tax administration, should GAAR be introduced, CII reference

GAAR provisions are “extraordinarily broad” and “too vague”:  
United States Council for International Business: July 2012

GAAR fears may have cost Indian markets \$10 bn  
foreign money: May 2012

“The real downside of GAAR is not the tax cost because Business does not depend on or seek to profit from abusive tax avoidance but, the hassles, the reputational risks, the diversion of management time and effort and the stress of dealing with invocation of GAAR” – Group MD, Reliance

“A pragmatic and practical view has been taken in recommending a deferral in the implementation of GAAR at a time when business sentiment desperately needs a boost” – President, FICCI

**Introduction of GAAR not a concern**

**Administration and implementation of GAAR – The real concern**

# GAAR around the World

Key Pointers	Canada	Australia	China	UK(proposed)
<b>Trigger Point</b>	Primary purpose is obtaining tax benefit coupled with lack of bona-fide non-tax purpose	Sole or dominant purpose is obtaining tax benefit	No reasonable commercial purpose coupled with reduction of taxable revenue / income	Abnormal arrangements which are contrived to achieve abusive tax results
<b>Tests – Tax motivated?</b>	Purposive interpretation Approach to be adopted	8 Bright line test to determine dominant purpose  Principle of Predication - counterfactuals – analysis	Relationship between each step / component of the arrangement and ensuing tax results evaluated	All circumstances taken into regard to determine if ‘main purpose’ or ‘one of the main purpose’ is tax motivate
<b>Treaty vs GAAR</b>	Treaty over-ride	Treaty over-ride	Treaty over-ride unless other wise provided	Treaty over-ride
<b>Clearances / GAAR panel / Advance Rulings</b>	Committee constitutes representatives from CRA, Dept of Finance & Dept of Justice  Panel plays purely a consultative role	The Panel constitutes senior tax officials and business professionals.  Panel plays purely a consultative role	All GAAR investigations and adjustments mandate prior approval from SAT	Panel , chaired by independent person contains a non-revenue member having relevant expertise  Panel plays purely a consultative role

A close-up, grayscale photograph of a car's front wheel and tire. The image is partially obscured by a large, semi-transparent blue overlay that covers the top and right portions of the frame. The text 'GAAR in India' is centered within the blue area.

# GAAR in India

## Jurisprudence

- Tax Planning vs. Tax Avoidance vs. Tax Evasion / Form vs. Substance
- Treaty Shopping
- Thin Capitalization



## Specific Anti-Avoidance Rules

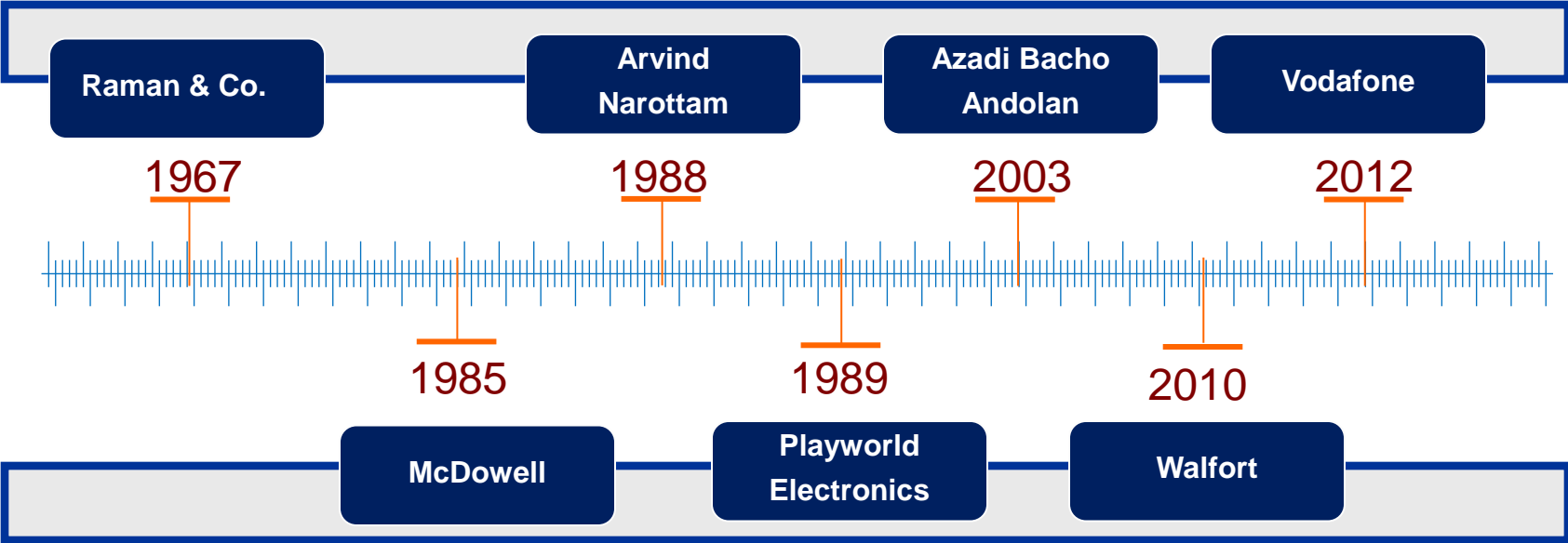
- Deemed Dividend
- Clubbing of Income
- Stamp duty value of Land & Building
- Deemed Gift
- Transfer Pricing, SDT and other Budget amendments
- Dividend/Bonus stripping
- Disallowance of excess expenditure u/s 40A(2)

## Tax Treaties and Tax information Exchange agreements

- Limitation of Benefits clause in certain Treaties
- Tax information exchange agreements with countries with which India has not signed treaties [eg. Bahamas, Bermuda, Isle of Man, British Virgin Islands, Cayman Islands, Jersey, Gibraltar, Monaco]

# Tax Planning vs. Tax Avoidance vs. Tax Evasion

**'Roller Coaster' from "post-independence" to 2012..... 60+ years ... 7 Apex Court decisions !!**





# Tax Planning vs. Tax Avoidance vs. Tax Evasion – Judicial View

*Every man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure that result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax”*

**(IRC v Duke of Westminster [ 1936 ] AC1 (HL)). – UK case law**

*Decision in McDowell’s Co. Ltd.’s case cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement which is perfectly permissible under law, which has the effect of reducing the tax burden of the assessee, must be looked upon with disfavour*

**M.V.Valliappan v. CIT [1988] 170 ITR 238 (Mad)**

*The Supreme Court held that the dividend stripping transactions cannot be considered as sham or bogus transaction and use of the provisions of the Act cannot be called as ‘abuse of law’.*

**CIT v. Walfort Share & Stock Brokers (P.) Ltd. [2010] 192 TAXMAN 211 (SC)**

# GAAR in India – Overview

- Introduced in Direct Tax Code, Bill 2009 and retained in Direct tax Code, Bill 2010 - Made law by the Finance Act, 2012 by insertion of Chapter X – A, to codify ‘substance over form’ doctrine in order to protect tax base

Section	Overview
95	Applicability of GAAR
96	Impermissible avoidance arrangement (IAA)
97	Determinants of existence or otherwise of commercial substance
98	Consequences of IAA
99	Treatment of connected person and accommodating party
100	Applicability of Chapter X-A in addition to / in lieu of any other basis for determining tax liability
101	Chapter X-A to be applied in accordance guidelines to be framed
102	Definitions
144BA	Administration of GAAR

- Draft guidelines :Section 101 – Recommendations given by Committee formulated by CBDT in June 2012
- Expert Committee (EC) constituted under PM approval to give recommendations and finalise guidelines for GAAR – EC report submitted in September 2012

## Effective date of applicability

- Originally slated to be introduced from 01 April 2012 as per Finance Bill 2012; Enacted to be applicable from 01 April 2013
- EC recommends deferment to 01 April 2016 – a period of 3 years; to be confirmed by pre-announcement
- *Canada had introduced GAAR w.e.f. 1988, Australia w.e.f. 1981, China w.e.f. 2008*

## Grandfathering of existing structures

- No provision in the Act for grandfathering; Draft guidelines suggested that GAAR be applicable for income accruing after 01 April 2012
- EC recommends grandfathering all existing investments and not arrangements to prevent misuse of GAAR tool
- *Canada, Australia and South Africa provide for grandfathering with specific shelters for steps of composite arrangements undertaken prior to introduction*

## Administration – Approving Panel

- The Act provided for 3 member approval panel comprising of members from The Revenue alone - 2 officers at the level of CCIT or higher and 1 officer from Ministry of Law /level of Joint Secretary or above
- EC recommends **5 member approval** panel in lieu of 3 comprising of High Court retired judge, **2 Non-governmental officials**, 2CCIT / CCIT and CIT.
- Focus on investing in the independence of approving panels – Learning point from the DRP experience
- *Approving Panels in Australia and Canada play purely a consultative role in the GAAR assessment process with the Australian Panel comprising of senior tax officials and business professionals and Canadian Panel constituting representatives from CRA, Department of Finance and Department of Justice*

## Impermissible Avoidance Arrangement - Section 96 – Key determinants

### Main purpose test

- As per the Act, if the main purpose or one of the main purposes is obtaining a tax benefit, GAAR can be invoked.
- Tax benefit defined in section 102 to include a reduction, avoidance or deferral of tax, or other amount increase of refund of tax or other amount under the Act or tax treaty or a reduction in total income, including increase in loss
- EC recommends that GAAR may be invoked only **if the main purpose is obtaining a tax benefit.**
- **Applicability of the main purpose test illustrated by way of Examples 14, 18 of the ECR**
- *Australia adopts the Principle of Predication by evaluating Commercial, convenience and tax cost test of counterfactual to determine sole purpose – 8 Bright Line Test - a stark differentiator*

### Misuse/Abuse Test

- Act does not provide any guidance on interpretation of the term – misuse /abuse
- *Canada, Germany, South Africa adopt a purposive interpretation approach to determine whether the arrangement satisfies the abuse / misuse litmus test*
- EC recommends following global approach of purposive interpretation and diluting the over-arching principle by invoking GAAR only in case of abusive, artificial and contrived arrangements.
- **Eg 15, 25 of ECR**

## Impermissible Avoidance Arrangement - Section 96 – Key determinants

### Commercial Substance Test

- Section 97 of the Act prescribes scenarios in which arrangement would be deemed to lack commercial substance along with the relevance of key factors

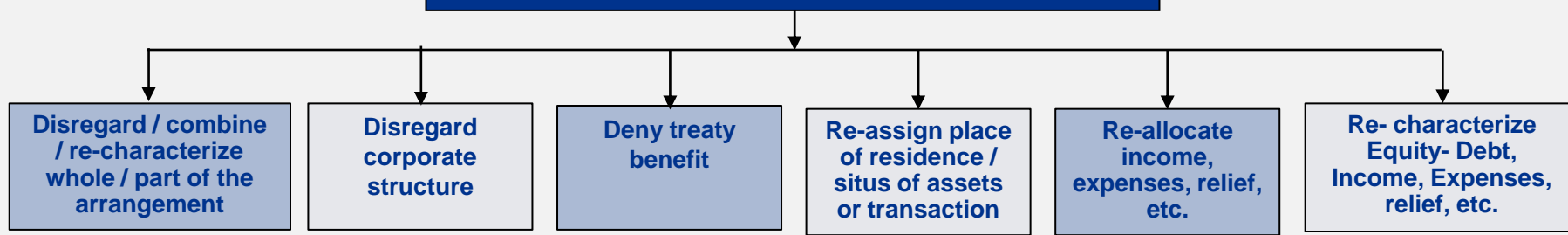
### Abnormal Arrangement Test not for bona-fide purposes

- Act does not provide guidance on the given tainted element test
- *The Draft UK report on GAAR directs abnormal arrangements to be viewed objectively and holistically having regard to all circumstances*
- EC has provided illustrations depicting arrangements not for 'bona fide purposes' - [Eg. 24 of ECR](#)

### Arm's Length Test

- EC recommends GAAR not to apply when SAAR applicable, since SAAR will check tax abuse
- In cases where TP provisions are not applicable, EC recommends AO to seek TPOs view to assess whether rights / obligations between parties are at arms length - [Eg. 22 of ECR](#)

## Consequences of IAA – Section 98



## Commercial Substance Test (Section 97)

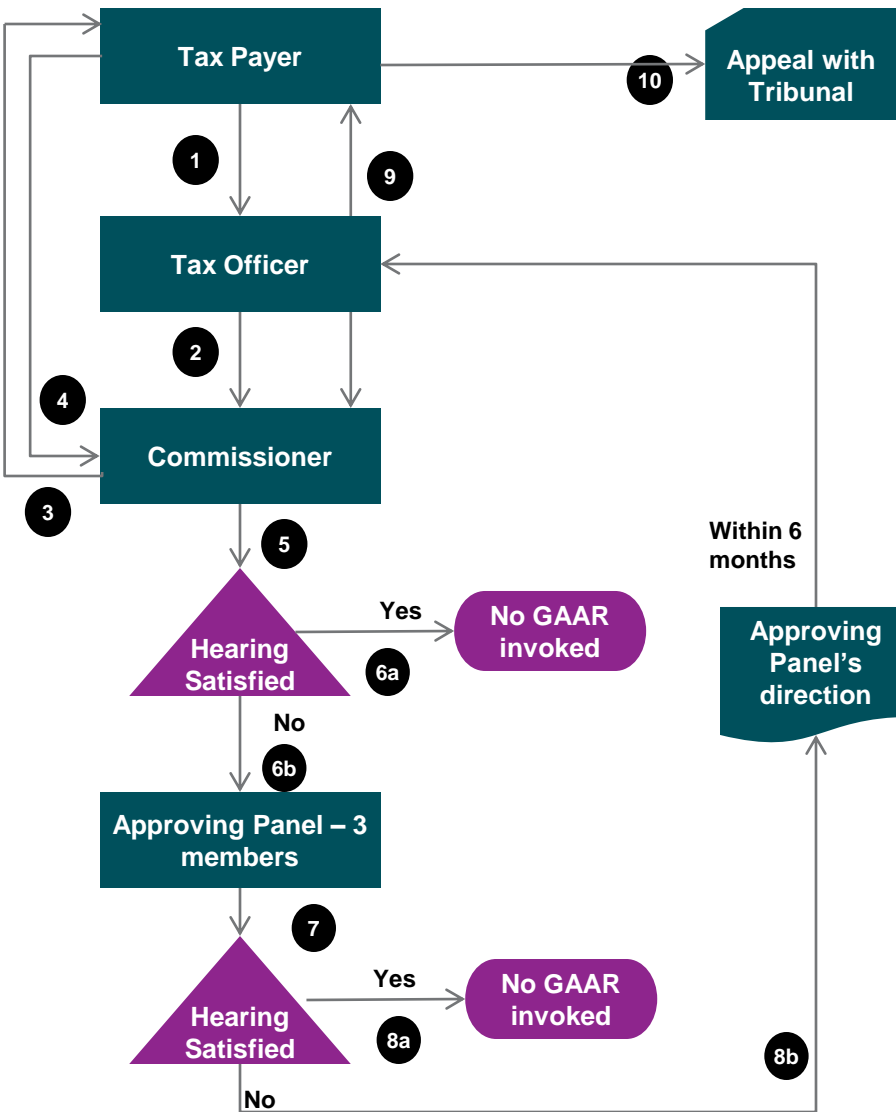
- Ensuing effect of arrangement inconsistent with form of its individual steps
- Following arrangements deemed to lack commercial substance:

Arrangement	ECR Eg.
Accommodating Party	<u>5B</u>
Round Tripping	<u>6,7</u>
Transactions conducted through one/more persons with the intent to disguise underlying substance	<u>23</u>
Elements result in cancelling/offsetting each other	-

- Location of asset / transaction or place of residence of any party is without any substantial commercial purpose other than obtaining a tax benefit
- Factors determining commercial substance

Factor	Source
Time period of existence of arrangement	• Act expressly provides such factors shall not be considered, while determining commercial substance
Payment of taxes under the arrangement	• Impact on business risks or net cash flows considered relevant for determining commercial substance by DTC Bills 2009 & 2010
Provision of exit route by the arrangement	• <b>ECR specifically provide that the given factors would be relevant to determine commercial substance although not sufficient</b> <i>Vodafone 6 factor test revalidated</i>

# GAAR Administration – Section 144BA



1. Tax Officer to consider arrangement as IAA
  2. Tax Officer to refer the arrangement to Commissioner
  3. Commissioner to issue notice to tax payer
  4. Tax Payer to furnish the objection **within 60 days of receipt of notice**
  5. Opportunity of hearing to the tax payer
  6. a) No GAAR - if Commissioner is satisfied  
b) Else, reference to Approving Panel
- Time for point 6 - 60 days from receipt of objections**  
**Over-all ceiling of 6 months from end of month of receipt of reference from AO**
7. Approving Panel to give opportunity of hearing
  8. a) No GAAR invoked - if Approving Panel is satisfied  
b) Else, Approving Panel to issue such directions declaring an arrangement as IAA
- Directions of AP – 6 months from the end of the month in which reference from Commissioner received**
9. Tax Officer to compute the consequences and pass final assessment order
  10. Appeal against order lies before the Tribunal

# Expert Committee Recommendations – Key Positives

## Mauritius Structures and Treaties with LOB blessed

- GAAR not to override CBDT Circular 789 of 2000 with reference to India-Mauritius tax treaty
- Mauritius Treaty should be revisited rather than challenging the same indirectly through GAAR
- Circular 789 of 2000 to be retained until tax on transfer of listed securities is abolished
- Investments into India through countries with which India's tax treaty has an LOB clause (eg. Singapore, Luxembourg, US, Iceland, UAE,, Mexico etc.) will not be examined under GAAR, since treaty has specific SAAR in form of LOB
- **Eg. 11 of ECR clearly demonstrates that GAAR wont be applicable in case of Mauritius / Singapore**

## GAAR invocation at the point of withholding taxes

- GAAR not to be invoked while processing 195(2) /197 application if undertaking from tax payer obtained
- Undertaking to pay tax along with interest in case it is found that GAAR applicable
- Where undertaking not obtained, GAAR may be invoked with prior approval of CIT while processing 195(2) / 197 application



# Expert Committee Recommendations – Key Positives

## Treaty Override

- As per the Act and draft guidelines, GAAR provisions to override Treaties
- Treaties having LOB clause, SAAR over-rides. In exceptionally abusive cases, GAAR to supercede
- EC specifically provides that where tax treaties contain in-built treaty abuse provisions, GAAR will not apply. **Eg. 16** - EC has not sought to interpret / comment on LOB clause in India-Singapore treaty
- Article 1 of OECD convention vis-à-vis Article 27 of Vienna convention

## Compensating adjustment

- Not discussed in the Act or guidelines
- ECR provide that corresponding adjustment may be given to the same taxpayer in the same years or in different years as applicable
- ECR specifically prohibit no corresponding adjustment to any other tax payer may be given - **Eg 6, 23**
- *Australia and South Africa specifically provide for compensating adjustments to other parties.*

# Expert Committee Recommendations – Key Positives

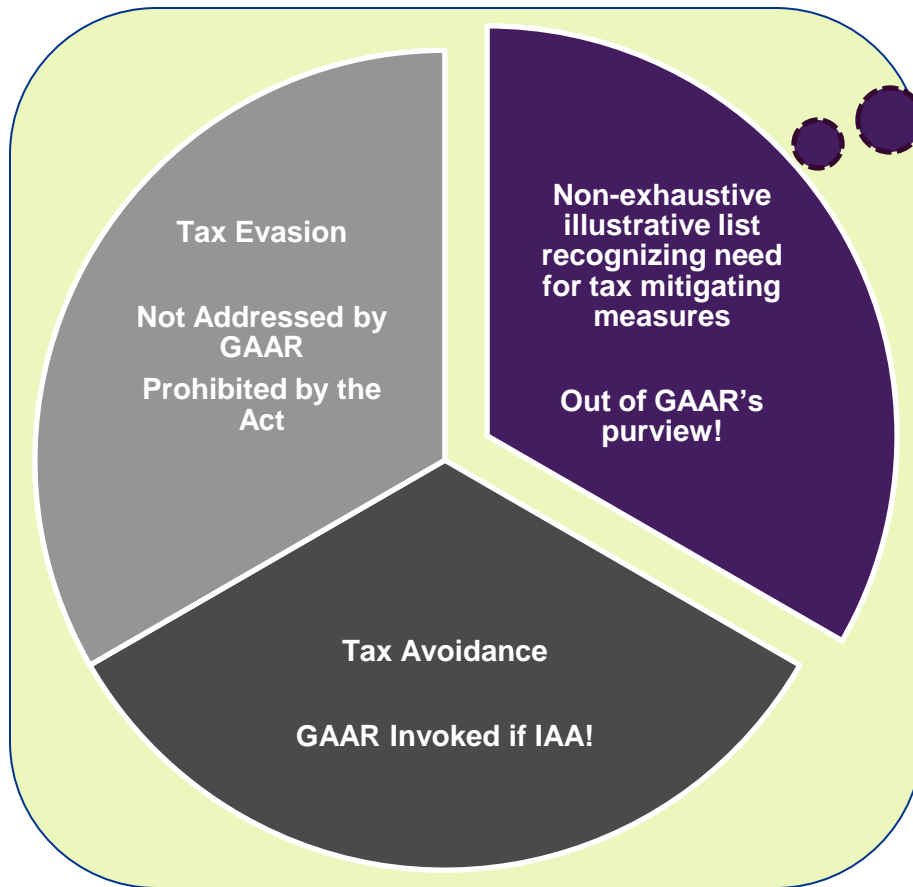
## Monetary Threshold

- Draft Guidelines recommend stipulation of monetary threshold to avoid indiscriminate application of GAAR without mentioning the quantum
- EC recommends Tax benefit (excluding interest, etc) of INR 30 million in a year as threshold; DDT, Profit distribution tax benefits to be considered
- Tax benefit in case of tax deferral, to be considered in the year of deferral based on present value of money

## Administration Mechanism

- EC recommends intensive training to department staff; Detailed Reasoning and demonstration by tax authorities for invoking GAAR
- Has provided timelines in cases for CIT to act on objection of tax payer
- Recommends strengthening of AAR mechanism to obtain a ruling on whether an arrangement is impermissible or otherwise within a period of 6 months
- **Tax audit report to disclose tax avoidance scheme – Similar to FIN 48 requirement in the US?**
- *Although UK has its GAAR regime in the pipeline, to counter abusive tax avoidance schemes, it had introduced “the “Disclosure of Tax Avoidance Schemes” rules which requires persons engaged in tax avoidance of prescribed types to disclose schemes at a very early stage to HM Revenue & Customs*
- *GAAR embodied in self assessment done by taxpayer*

# Recommended Negative List (Positive List!!!)



- ✓ Selection of one of the options offered in law
  - Payment of dividend or buy back of shares by a company
  - Setting up of a branch or subsidiary
  - Setting up of a unit in Special Economic Zone (SEZ) or any other place
  - Funding through debt or equity
  - Purchase or lease of a capital asset
- ✓ Timing of a transaction, for example sale of property in loss while having profit in other transactions.
- ✓ Amalgamation and demergers as approved by the High Court.
- ✓ Intra-group transactions (i.e. transactions between associated persons or enterprises) which may result in tax benefit to one person without affecting the overall tax revenue either by actual loss of revenue or deferral.

**Need for conducive economic environment and well-defined guidelines and safeguards**

A close-up photograph of a hand holding a smartphone. The phone's screen is partially visible, showing a faint illustration of a globe. A large, semi-transparent blue overlay covers the middle of the image, featuring the text 'Select Illustrations' in white. The background is a plain, light color.

# Select Illustrations

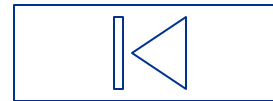
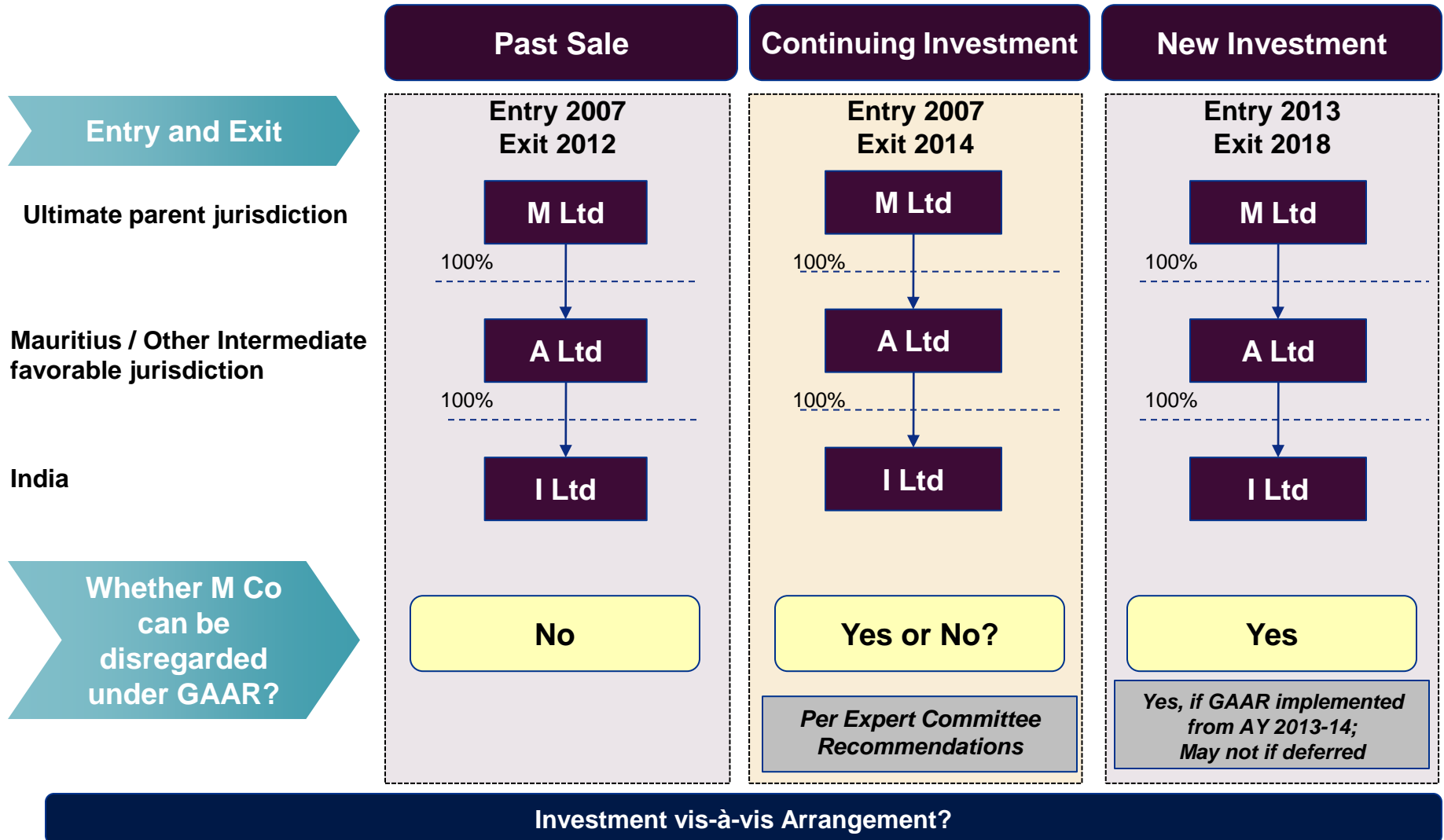
# An overview

- Draft guidelines had 21 examples to clarify applicability and non-applicability of GAAR
- Expert Committee has in effect provided 37 examples to illustrate applicability or non applicability of GAAR
- Barring Example 3, part of Eg. 6, Eg. 15, eg. 18 of the Draft guidelines, all the other examples have been addressed in Expert Committee Recommendations
- In certain cases, Expert Committee has drawn positive conclusion than the Draft guidelines. The same is tabulated below:

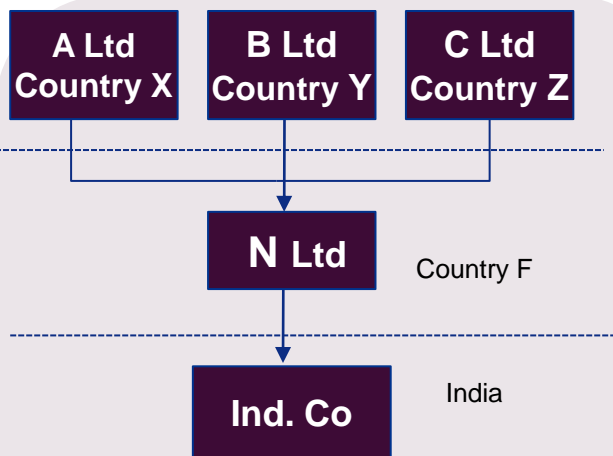
Aspect	Draft Guidelines	Expert Committee
<u>Tax Evasion</u>	2, 17	1A, 17
<u>Mauritius/Singapore Investment</u>	11	11
Business Decision		
▪ <u>Buy Back</u>	12	12B
▪ <u>Timing &amp; Sequencing of events</u>	13	13
<u>Treaty – SAAR</u>	16	16
<u>Act – SAAR</u>	21	21

- Key takeaway from illustrations provided in Expert Committee Recommendations is that GAAR would not be attracted in routine day to day transactions, and in transactions with unrelated party

# Grandfathering of Investments



# Main Purpose Test

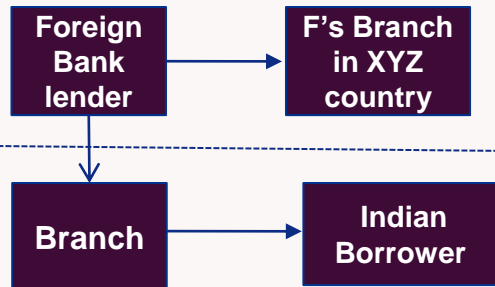


## Facts

- N Ltd an SPV located in a no-tax jurisdiction has invested into Ind Co.
- Country F has been chosen considering low cost of compliance and availability of BIPA with India

**GAAR not to be invoked** (Eg, 18 of ECR)

**Tax benefit is only one of the main purposes and not the main purpose**

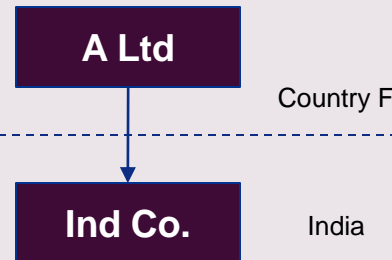


## Facts

- “F’s” branch in India arranges loan for Indian borrower
- The loan is later assigned to “F” bank’s branch in XYZ country to take benefit of withholding provisions of the India-XYZ treaty

**GAAR to be invoked** (Eg, 14 of Draft Guidelines and ECR)

**Tax motivated transaction**



## Facts

India-F treaty provides that where A sells more than x% interest of Ind Co. in one lot, gains are taxable in India

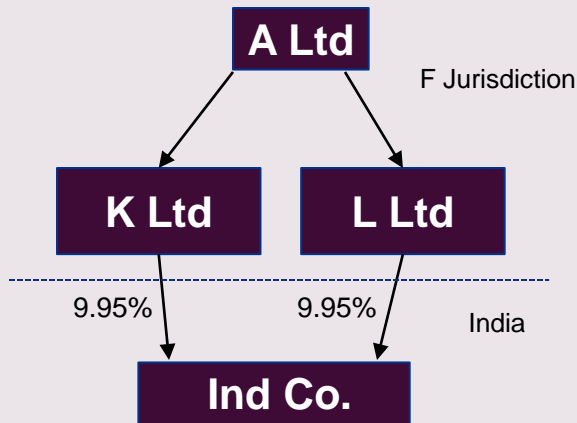
A sells shares in installments wherein individual quantum is less than x% for each installment, though total sale is more than x%

**Main purpose – Tax motivated – GAAR invoked** (Eg. 15 of Draft Guidelines)

**Quantum of sale depends on cash requirements of A Ltd – ‘one of the main purpose – tax benefit?’**



# Misuse/Abuse Test



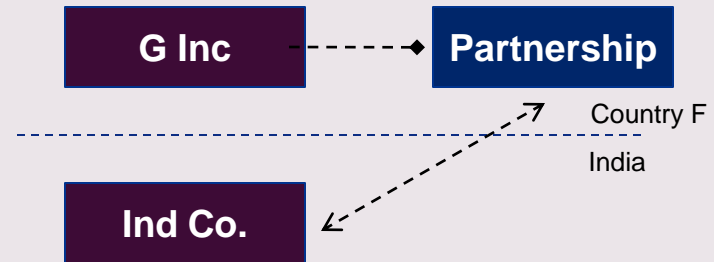
## Facts

India-F treaty provides that gains arising from sale of shares will be taxable in India if transferor holds more than 10% in Ind Co.

A Ltd invests in Ind Co. through K Ltd and L Ltd each holding 9.95%. Subsequently, K Ltd and L Ltd sell shares in Ind Co. and claim treaty benefit.

**Tax motivated – Abuse of Treaty - GAAR invoked** (Eg. 15 of ECR)

**No significant change in the economic condition of A Ltd by creating 2 subsidiaries**



## Facts

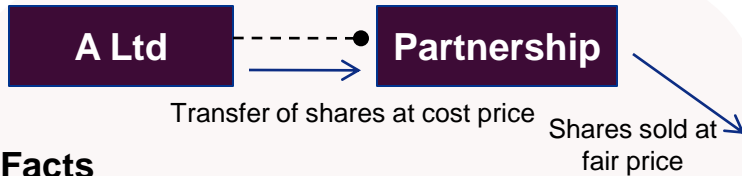
- G Inc. receives offer from Ind Co. for design services in India. India-F treaty provides that technical services rendered by a Co. would be taxable in India.
- Treaty provides where such services rendered by a firm/individual then services would be taxed in India if firm/individual has a fixed base in India, stay of partners/employees > 180 days
- G Inc. forms a partnership with a third party ( Director of G Inc. and contract is entered with firm.

**Tax motivated – Treaty Abuse - GAAR invoked** (Eg. 25 of ECR)

**Firm disregarded and design fee taxable in India as FTS**



# Abnormal Test and Arm's length Test

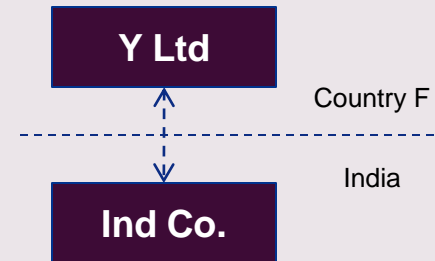


## Facts

- A Ltd invests in 1 crore in shares and after a year FMV of shares become 11 crores.
- To avoid MAT on Long Term Capital Gains on sale, A Ltd forms partnership firm with a nominee and transfers shares at cost price
- Partnership firm subsequently disposes the shares without any tax cost and gains arising is distributed to A Ltd by dissolving the firm which is again exempt

**Tax motivated - Transactions undertaken in Abnormal Manner – GAAR invoked**

(Eg. 24 of ECR)

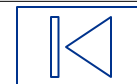


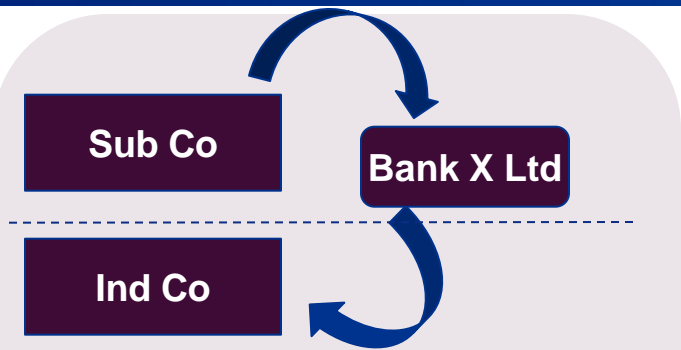
## Facts

- Y Ltd enters into a composite agreement with Ind Co. (unrelated party) for set up of power plant in India. Contract split into 3 parts –
    - ✓ USD 10 million for design outside India (taxable in India)
    - ✓ USD 70 million for offshore supply of equipment (not taxable in India as no PE) and
    - ✓ USD 20 million for local installation (taxable in India)
- FMV ascertained - Offshore design under-invoiced and off-shore supply over invoiced

**Tax motivated – Not at arm's length - GAAR invoked**  
(Eg. 22 of ECR)

**Prices to be reallocated based on TP Regulations**





**Facts**

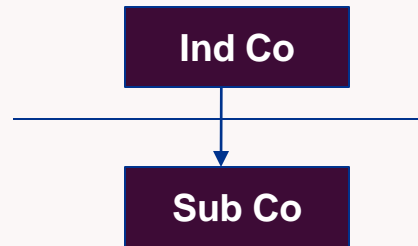
Ind Co has a subsidiary in overseas location. Sub Co. makes a deposit with X Ltd Bank. Based on this security X Ltd provides loan to Ind Co.

**GAAR to be invoked** (Eg. 5B of ECR)

**Main purpose to avoid deemed dividend implications upon receipt of loan directly from Sub Co**

**X Ltd Bank may be treated as accommodating party**

**Arrangement deemed to lack commercial substance**



**Facts**

Ind Co invests into overseas subsidiary.. Sub Co. lends an equivalent amount to Ind Co. Sub Co. does not have reserves and does not carry on any activity

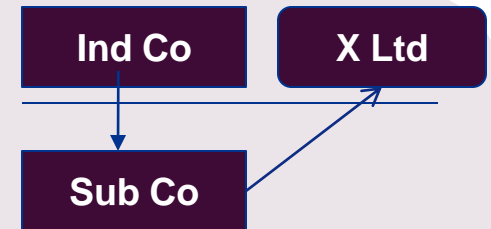
**GAAR to be invoked** (Eg. 6 of ECR)

**Tax motivated transaction – Case of Round Tripping**

**Arrangement deemed to lack commercial substance**

Resulting in disallowance of Interest paid by Ind Co;

No corresponding adjustment in the hands of Sub Co.



**Facts**

Ind Co invests into overseas subsidiary.. Sub Co. lends an equivalent amount to X Ltd, in India Sub Co. does not have any other activity

**GAAR to be invoked** (Eg. 7 of ECR)

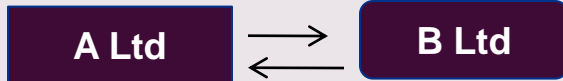
**Tax motivated transaction – to avoid tax on interest income if loan granted by Ind Co directly**

Arrangement deemed to lack commercial substance in view of **Round Tripping**

Result in taxability of interest income in Ind Co. hands



Sale of unlisted securities for Rs. 1000 in Year 1



Forward Contract for Sale of same unlisted securities for Rs. 1100 in Year 2

## Facts

A Ltd sells unlisted securities to B Ltd and enters into forward contract for repurchase of securities after 1 year at a higher price

B Ltd claims gain of Rs. 100 as LTCG not taxable at the rate of 30%

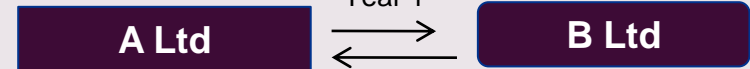
**Transaction disguises the value of underlying subject matter – No commercial substance – GAAR invoked (Eg. 23 of ECR)**

**The substance of effect of the arrangement is inconsistent with the form of individual steps**

**Capital gains may be recharacterized as interest income in the hands of B Ltd.**

**Corresponding deduction of interest expenses not allowed in the hands of A Ltd**

Sale of unlisted securities for Rs. 1000 in Year 1



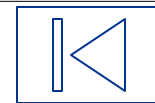
Put option for Sale of same unlisted securities for Rs. 1100 in Year 2

## Facts

A Ltd sells unlisted securities to B Ltd and enters into put option for repurchase of securities after 1 year at a higher price.

Market value of securities in year 1 is Rs. 900. and put option exercised

**Element of risk involved – Commercial transaction - GAAR not to be invoked (Eg. 23A of ECR)**



# Buy Back

**Share buy back**

- Ind Co. undertakes share buy-back over dividend distribution
- **As per ECR GAAR would not apply in view of:**
  - ✓ LoB clause in India-Singapore Treaty
  - ✓ CBDT Circular 789 of 2000 with respect to India-Mauritius

**SAAR over-rides GAAR**

**Selective share buy back**

- Ind Co undertakes share buyback from Mauritius shareholder alone  
*(Eg. 12 of Draft Guidelines and 12B of ECR)*
- Expert Committee concurs with Draft Guidelines - **GAAR may be invoked**
- *AAR Ruling in the case of 'A Ltd'\* upheld*

**Requirement of Cash by US Co. and UK Co. – A commercial call.**

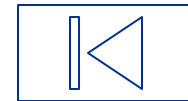
**Applicability of main purpose test?**

**Share Buy back**

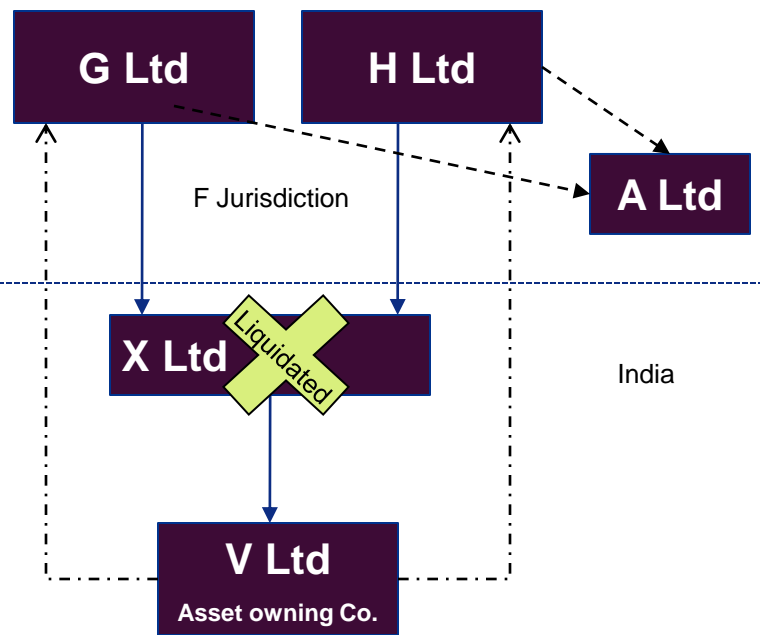
- Ind Co. undertakes share buy-back over dividend distribution
- Treaty does not have LOB clause
- Buy back vs. Dividend distribution – Choice available

**Outside purview of GAAR in view of prescribed negative list ?**

\*A.A.R. No. P of 2010 dated 22 March 2012)



# Disposal of assets vide Liquidation



**Tax Avoidance per Eg. 13 of draft guidelines - GAAR invoked**  
*Misuse or abuse of tax provisions*  
*Treaty benefit denied*

**Tax Planning per Eg 13 of Committee Recommendations - GAAR cannot be invoked**  
*Exercise of tax efficient option for asset disposal viz. proper sequencing not tax avoidance*  
 Alternative course of action available to taxpayer to achieve the same result

- Facts**
- India-F tax treaty - Non-taxation of capital gains in the source country and country F charges no / minimum capital gains tax per its domestic law
  - X Ltd. liquidated by consent and without any Court Decree.
  - Transfer of assets (inc shares in V Ltd) to G Ltd and H Ltd
  - G Ltd and H Ltd transfer V Ltd's shares to A Ltd

**Option 1**

*A Ltd. acquires shares of X Ltd. from G Ltd. and H Ltd.; X Ltd. is liquidated; and A Ltd. becomes shareholder of V Ltd.*

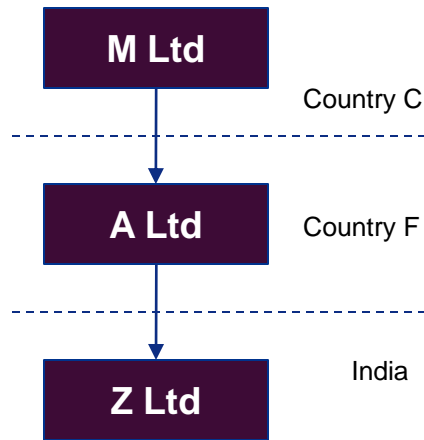
**Option 2**

*X Ltd. sells its entire shareholding in V Ltd. to A Ltd. and subsequently, X Ltd is liquidated*

- Deemed dividend taxation to the extent of available reserves at the time of liquidation*
- Additional tax liability if option 2 adopted - capital gains in the hand of X Ltd.*



# Treaty SAAR - Limitation of Benefits clause



## Facts

- M Ltd routes investment into Z Ltd via A Ltd, domiciled in country F with which India has beneficial capital gains tax treatment
- Later, A Ltd sells the shares of Z Ltd to C Ltd.
- India-F tax treaty has LoB clause with the protocol providing that A Ltd shall not be treated as shell/conduit company if its total annual expenditure on operations is  $\geq$  Rs. 10,000,000/- in preceding period of 24 months
- A Ltd has incurred Rs. 12,000,000 and claims treaty benefits

## GAAR Draft Guidelines (Eg. 16)

If Rs. 8,000,000 of the above expenditure represents interest to M Ltd, then such payment would not be considered for threshold purposes

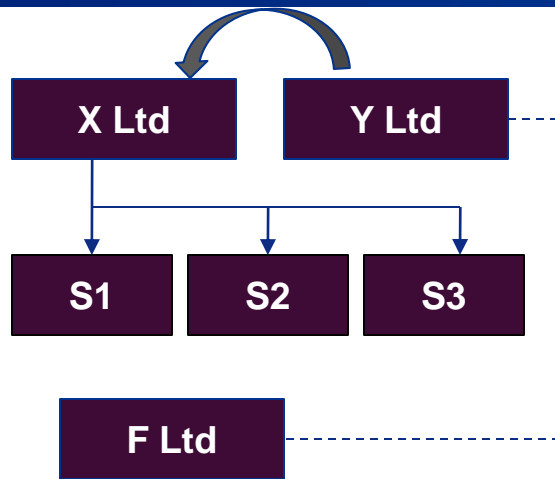
***Benefit denied under LoB clause and GAAR may also be invoked***

## Expert Committee Recommendations (Eg. 16)

If Rs. 12,000,000 constituted the annual operating business expenditure, then treaty benefits denied.

***GAAR cannot be invoked in view of presence of SAAR***

## SAAR in the Act – Section 56



### Facts

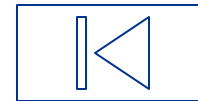
- X Ltd borrowed money from Y Ltd and uses the money to invest in shares of S1, S2 and S3 at 6 times the FMV.
- S1, S2 and S3 transfer the share money to F Ltd, a company connected to Y Ltd
- Later, X Ltd sells the shares of S1, S2 and S3 at one fifth the FMV and sets off the capital loss against the capital gains from other sources.

### **ECR (Eg. 21)**

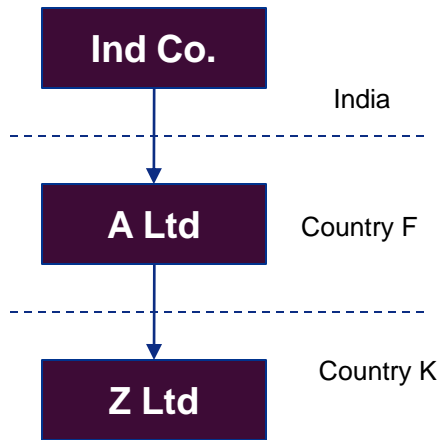
***X Ltd has obtained rights and obligations which are not ordinarily created and not at arm's length***

***Section 56 applies for shares issued at a value higher than FMV for closely held companies***

***GAAR cannot be invoked in view of presence of SAAR***



# Repatriation



## Facts

Ind Co has set up a company, A Ltd in a low tax jurisdiction outside India, which further has subsidiary company Z Ltd in other jurisdictions

## **Scenario 1:**

Z Ltd declares dividend to A Ltd which is not repatriated to Ind Co.

## **Scenario 2:**

A Ltd accumulates dividends for a number of years and subsequently is merged with Ind. Co

### Scenario 1

- Eg. 4 of Draft Guidelines and Eg. 2 of ECR
- Repatriation of dividend business choice
- India does not have CFC provisions

***GAAR cannot be invoked***

### Scenario 2

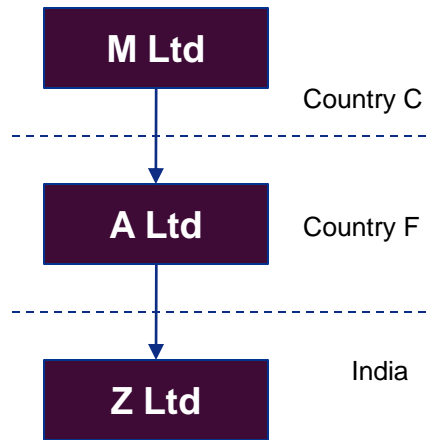
- Eg 2A of ECR
- Timing or sequence of activities is a business choice

***GAAR cannot be invoked***





# Treaty Shopping



## Facts

M Ltd routes investment into India via A Ltd, domiciled in country F with which India has beneficial capital gains tax treatment

## Scenario 1

Acquisition of shares in Z Ltd by A Ltd funded by M Ltd and A Ltd has no other transactions. Shares of Z Ltd subsequently disposed.

## Scenario 2

M Ltd invested in A Ltd which in turn invests in Z Ltd. A Ltd does not have any commercial substance

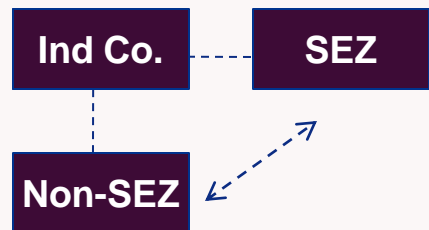
## Scenario 1

- Eg. 11 of Draft Guidelines and ECR
- Tax motivated transaction - **GAAR may be invoked**
- EC additionally qualifies that **GAAR will not be invoked if A Ltd is situated in Mauritius** or in a jurisdiction whose treaty with India has a LoB clause

## Scenario 2

- Eg. 18 of Draft Guidelines
  - Tax motivated transaction - **GAAR may be invoked**
- Additional qualifications of EC in Scenario 1 equally applicable?**

# Tax Evasion

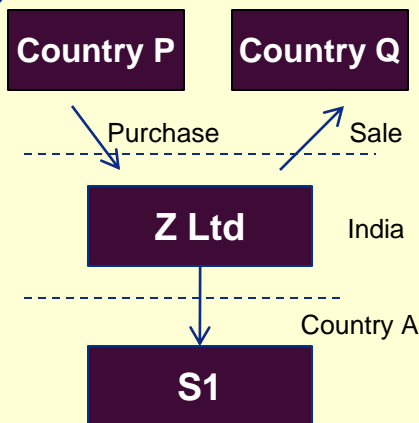


## Facts

Ind Co. discloses production of non-SEZ unit as from SEZ unit and claims tax holiday

**ECR (Eg. 1A) - Misrepresentation of facts – Tax evasion - GAAR not invoked**

**Draft Guidelines (Eg. 2) - Tax motivated - GAAR to be invoked**

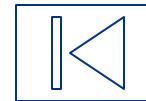


## Facts:

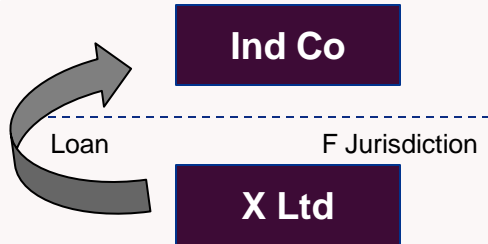
- Z Ltd sets up a subsidiary S1 in low / no tax jurisdiction and shows on documentation that contracts of purchase and sale concluded in India are concluded in S1
- Management and all activities carried on in India with goods moving directly from P to Q

**ECR (Eg. 17) - Misrepresentation of facts – Tax evasion - GAAR not invoked**

**In case of correct reporting of facts, still no GAAR because of specific SAAR(PE exposure and arm's length)**



# Thin Capitalization



## Facts:

Ind Co. raises loan from X Ltd, domiciled in low tax jurisdiction when it could have issued equity

**No specific thin capitalization rules in India**

**Capital funding a business judgment**

**GAAR not to be invoked (Eg. 5 of ECR)**



# The Road ahead

# Way forward

- **Take a clue from UK to build economy strengthen tax administration**
  - ✓ Encouraging investment and exports as a route to a more balanced economy;
  - ✓ Making the UK the best place in Europe to start, finance and grow a business;
  - ✓ Creating a more educated workforce that is the most flexible in Europe; and
  - ✓ Creating the most competitive tax system in the G20.
- **Clarity on P-Note transfers by way of circular, in view of diminishing P-note share in total FII assets**
- **Additional clarifications on capital gains taxability in the hands of PE, VCF, AIF on transfer of unlisted securities**
- **Absence of thin capitalisation rules in India – Amend law on recharacterisation of debt / equity**  
**(Example 5 of ECR)**
- **Extend Mauritius treaty protection key to investing jurisdictions (Cyprus, Netherlands)**
  - ✓ Need to ensure steady increase in global capital to be the ‘destination of choice’
  - ✓ India TRC rules for non resident investors can be suitably amended
- **Renegotiate tax treaties to have specific anti-abuse provisions inserted to curtail GAAR override vis-a- vis treaty**
  - ✓ GAAR application should not adversely impact capital flows from major investors in Mauritius, Singapore, UK, Japan, USA and Netherlands
  - ✓ Out of the top 6 investing countries, only US and Singapore have LOB clauses

# Way forward

- **Legislate additional specific anti-avoidance rules to reduce arbitrary invocation of GAAR by Revenue eg. CFC – Eg 2 of ECR**
- **All provisions relating to GAAR should be legislated; rather than supplemented by way of circulars to strengthen investor confidence**
- **Inbound investments from jurisdictions with which India has bilateral investment promotion and protection agreements (BIPA) – Presence of commercial substance! (Example 18)**
  - ✓ As of July 2012, India has signed BIPA with 82 countries
  - ✓ Key countries include Mauritius, UK, Netherlands, Switzerland and Cyprus
- **Tax payer service – Constitution of independent panel providing informal views on GAAR trigger – the UK way**
- **Orders under section 195(2) to provide certainty to tax payers - 195(2) orders once passed can still be subject to scrutiny**
- **Clarity on Advance Ruling option, considering recent negative trends in admission of applications**
- **Negate Tax audit reporting requirement by auditors for tax avoidance schemes – Burden of proof indirectly shifted to tax payer**
- **Corresponding adjustments, in case of tax consequences of IAA, to be permitted in case of other tax payer**
- **Clarifications regarding penalty under section 271(1)(c) where transactions covered by GAAR**

# Thank You

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