

**Deloitte  
Haskins & Sells**

# General Anti-Avoidance Rules (GAAR)

**FICCI - Tax Conference  
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The story so far...

## The story so far...

Date	Developments
12 August 2009	GAAR was introduced for the first time in the Direct Taxes Code Bill, 2009
30 August 2010	Some modifications in Direct Taxes Code Bill, 2010
27 February 2012	Committee was formed by CBDT to provide recommendations for formulating guidelines to implement the GAAR provisions and to draft a circular so as to ensure that GAAR is not applied indiscriminately
16 March 2012	Finance Bill 2012 proposed to introduce GAAR from 1 April 2012
28 May 2012	GAAR was deferred till 1 April 2013 on enactment of the Finance Bill 2012
28 June 2012	Draft GAAR Guidelines were released by Government of India
13 July 2012	Expert Committee (EC) on GAAR was constituted under the chairmanship of Dr. Parthasarathi Shome to vet and rework the GAAR Guidelines
1 September 2012	Report of the Expert Committee is published
1 October 2012	Final Report submitted by the Export Committee to the Finance Minister though not released

**Final Report under review by the Finance Minister and expected to be released within the next few days**

# Guidelines: Draft vs. recommendations

## Guidelines: Draft vs. Recommendations (1/2)

Issues raised	Addressed by Shome Committee
Application of GAAR too broad and subjective	Not to apply: <ul style="list-style-type: none"> <li>• where SAAR is applicable</li> <li>• where treaty has anti-avoidance rules</li> <li>• to corporate reorganizations approved by the High Court</li> <li>• where option offered in law is selected (the 'freedom of choice' principle)</li> </ul>
Effective Date – To apply to income accruing after trigger date. No clarity on the taxability of income arising after the trigger date from the arrangements entered into before that date	Grandfathering. Applies to Investments, not the arrangements
GAAR to apply where “main purpose <u>or</u> one of the main purposes” is obtaining tax benefit	<u>Only</u> arrangements having the main purpose of obtaining tax benefit to be covered under GAAR

## Guidelines: Draft vs. Recommendations (2/2)

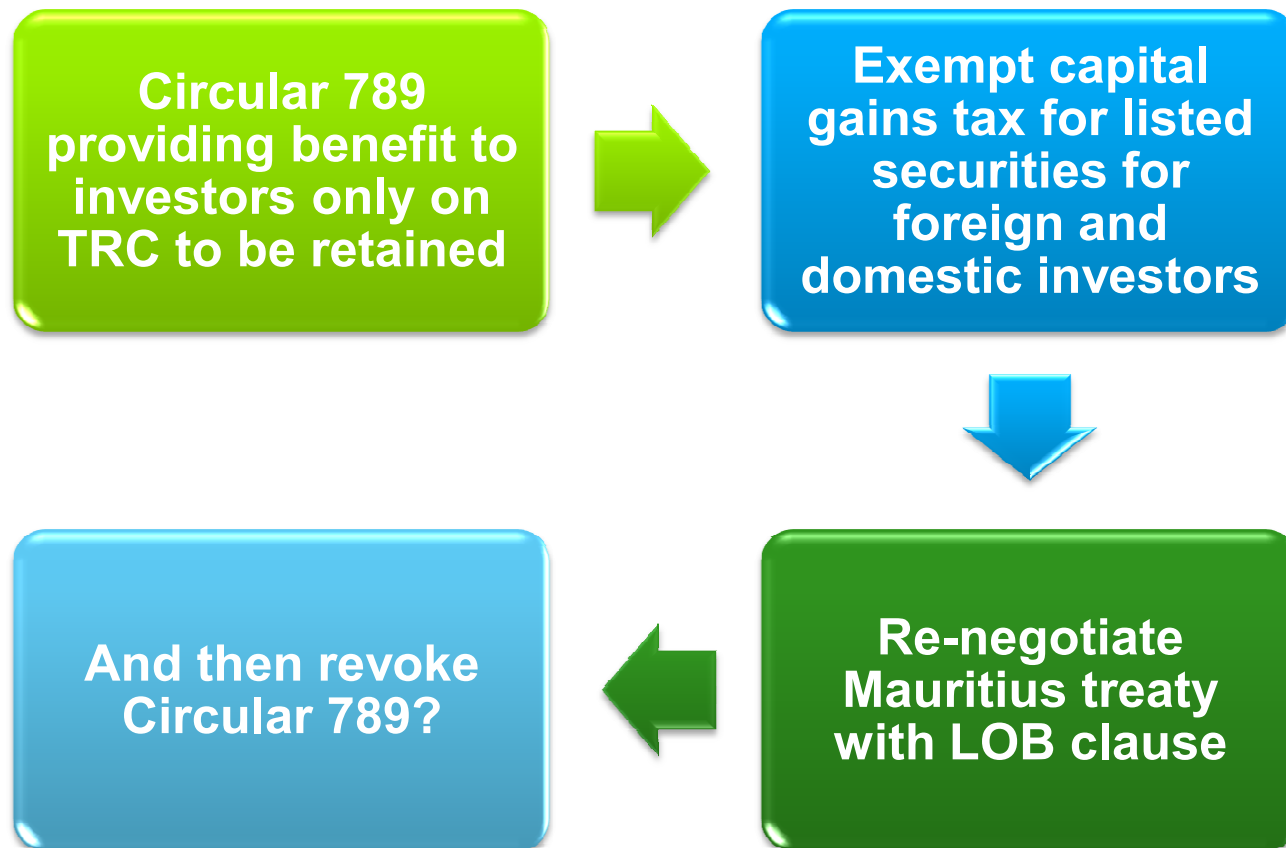
Issues raises	Addressed by Shome Committee
<p>“Commercial substance” not defined, only situations specified where it is deemed to be lacking</p>	<p>An arrangement deemed to be lacking commercial substance if it does not have a significant effect upon the business risks or net cash flows apart from any tax benefit (South African GAAR &amp; DTC).</p> <p>Following factors not to be totally irrelevant (as against existing law):</p> <ul style="list-style-type: none"> <li>• period or time for which the arrangement exists</li> <li>• payment of taxes, directly or indirectly, under the arrangement</li> <li>• the fact that an exit route is provided by the arrangement</li> </ul>
<p>No corresponding adjustment of tax consequences</p>	<p>Allowed only in the case of taxpayer</p>

# Issues that remain...



## But before that, lets understand the direction...

- Tax authorities need training and a 3 year postponement is warranted
- The promise given to foreign investors must be kept. But how...?



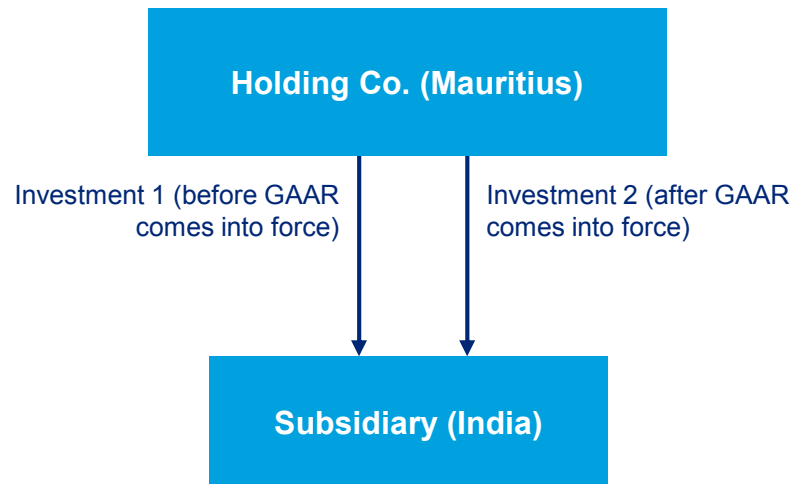
## Until then, is Circular 789 a free pass ?

- Circular No. 789 laid down that Tax Residency Certificate issued by Mauritian Revenue Authority to be sufficient proof of residence as well as beneficial ownership
- Consequently, no question of beneficial ownership to be raised (except for round tripping situations) and sole basis would be the TRC
- Focus now will be on the applicability of Circular 789
  - Does it apply only to Mauritius or can it be extended to other countries?
  - The Mumbai ITAT referred to it in context of the Dutch treaty in the case of Universal Music
  - AAR in Abdul Rezak's case however held that it did not apply to other countries
  - But if it does, then does it override the LOB clauses of treaties?

# Grandfathering... is the meaning clear ?

## Investments vs. arrangements

- All future investments by an intermediary holding company set up pre GAAR cannot be outside the ambit of GAAR, hence investments and not arrangements are grandfathered.



# Commencement date for GAAR

	Appointed date	Applicable to
UK	1 April 2013 (proposed)	<ul style="list-style-type: none"> <li>GAAR should apply fully to tax advantages arising from arrangements entered into, on or after proposed commencement date of 1 April 2013; and</li> <li><u>Not to apply to tax advantages arising from arrangements fully completed by that date</u></li> <li>UK government seeking comments on the transitional rule</li> </ul>
<b>Australia</b> (amendments to existing GAAR to be introduced in Parliament in second half of 2012)	1 March 2012 (proposed amendments)  (Australia's GAAR as covered by Part IVA of the ITAA, was introduced to apply to 'schemes' entered into after 27 May 1981)	<ul style="list-style-type: none"> <li><u>Amendments will apply to schemes entered into or carried out after 1 March 2012</u></li> </ul>

# Measuring “main purpose”

## Main purpose

- Correction of anomaly
- Predication principle followed
- Synonymous with Main, Dominant, Sole, Primary, Principal
- ***Europa Oil (NZ) Limited v CIR*** [1976] 1 WLR 46423 (known as ***Europa (No 2)***) at 475, per Lord Diplock:

*“[GAAR] does not strike down ordinary business or commercial transactions which incidentally result in some saving of tax. There may be different ways of carrying out such transactions. They will not be struck down if the method chosen for carrying them out involves the payment of less tax than would be payable if another method was followed. In such cases the avoidance of tax will be incidental to and not the main purpose of the transaction or transactions which will be the achievement of some business or commercial object.”*

## 8 bright-line tests in Australian GAAR for measuring ‘sole or dominant purpose’

- 1) Manner in which the scheme was entered into;
- 2) Form and substance of the scheme;
- 3) Time when entered and the length of the period during which the scheme was carried out;
- 4) The income tax result that, but for Part IVA, would be achieved by the scheme
- 5) Any change in the financial position from the scheme;
- 6) Any change in the financial position of any person who has any connection with the tax payer from the scheme;
- 7) Any other consequence for the relevant tax payer or for any (connected) person of the scheme; and
- 8) Nature of any connection between the relevant tax payer and any person referred to in (6)

# Adequacy of commercial substance

- Example (No. 3) in the draft Guidelines uses the following facts to conclude that the holding company has substantial commercial substance in a country outside India:
  - Does business in that country
  - Has board of directors that meets in that country
  - Carries out business with adequate manpower, capital, infrastructure
- What is adequate? – Depending upon the nature and level of business activity, a handful of employees in small office premises and minimal capital may also be adequate, viz. bookkeeping business
- Recommendation made by Shome Committee – however, another deeming fiction for situation lacking commercial substance. But what does commercial substance mean?
- Factors that may be considered:
  - Key factors: Economic substance i.e., economic activities carried on, risks assumed and benefits derived
  - Additional factors: Commercial presence by way of local office, local directors, situs of board meetings, local bank accounts

# Adequacy of commercial substance

South African GAAR provisions lay down a few indicative 'Commercial Substance' tests:

- Anticipated pre-tax profit insignificant in comparison to value of the anticipated tax benefit.
- Paying more or less than market value for assets or services.
- Inconsistent characterization of the arrangement by the parties for tax purposes.
- Arrangement results in significant deferred tax liabilities or permanent differences for financial reporting purposes.
- Level of complexity of an arrangement and the insertion of unnecessary steps. (other than to derive tax benefits)
- Avoidance arrangements are frequently characterized by high transaction costs, often as a direct result of the unnecessary steps and complexity inherent in such schemes e.g. administrative fees for accounting, legal and financial services rendered in implementing the arrangement in question.
- Presence of a fee variation clause, or of provisions whereby tax risk is shifted to a particular party to the arrangement.
- Timing and duration of arrangement or failure to adhere to normal business practices.

# Beneficial ownership

- One of the deeming fiction in Section 97 (situations where arrangement shall be deemed to lack commercial substance) refers to “ownership”
- The term “ownership” is critical to the application of GAAR – however not defined in the Act
- In China:
  - “Beneficial owner” refers to a person who has the right of ownership and control over the item of income, or the right or property from which that item of income is derived. A beneficial owner, generally, must be engaged in substantive business activities and can be an individual, a corporation or any other group ~ China State Administration of Taxation ("SAT") Circular 601 dated October 27, 2009
  - Safe harbor for listed companies
  - In case of income (dividends, interest or royalties) received through agent or nominee – the principal may apply to be considered the beneficial owner of the income, provided the immediate recipient of the income declares that it is not the beneficial owner ~ SAT Circular 30 dated June 29, 2012



# Consequential issues

- Corresponding adjustment only to the taxpayer: whether fair?
- Specifically, as regards withholding tax when any expenditure is re-characterized – applicability of withholding tax provisions, refund of taxes withheld
- The UK GAAR Consultation Document proposes consequential adjustments on a just and reasonable basis. Australian GAAR also permits compensating adjustments on a fair and reasonable basis.

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