GAAR: The Past, Present and Future.

Including highlights of the expert committee report and the finance ministers statement

© Arkay & Arkay, Chartered Accountants- 2013
# TABLE OF CONTENTS

- Introduction .................................................................................................................. 3
- GAAR: Concept .............................................................................................................. 3
- GAAR in other countries. ............................................................................................... 4
- Experiments with GAAR in India .................................................................................. 5
- Impact ............................................................................................................................. 5
- Report of the Expert Committee on GAAR ................................................................. 6
- Implementation Issues ................................................................................................. 14
- Illustrations .................................................................................................................... 15
- The Future of GAAR: Closing Remarks ....................................................................... 22
Introduction

The rise of the Indian economy in past two decades has been one of the most impacting events to occur in the country post its independence from its colonial rulers. One of the most significant markers of this growth has been the resilience of the economy to external pressures and troughs. The Indian economy has been relatively unscathed in the aftermath of the global financial meltdown of 2008. The country has seen a massive rise in gross domestic production (“GDP”) and consequently per capita incomes have also risen across the board.

The Indian economy no longer functions as a singular isolated entity, in the globalized era that exists today cross border trade and transactions are the norm rather than the exception. In such a circumstance organizations are more than likely to move operations to countries where suitable conditions exist for such businesses to flourish. Such movement of business and consequently profits outside India is not looked in a good vein by the government. It is therefore, in the interest of safeguarding the interests of revenue that the General Anti Avoidance Rules (“GAAR”) were proposed by the honourable erstwhile finance minister Mr Pranab Mukherjee along with the finance act 2012.

This paper is our humble attempt at demystifying GAAR and to chart out the past, present and perhaps the future of this critical regulation.

GAAR : Concept

The most obvious issues in taxation today arise over the geographical boundaries which, under our current tax law, determine the allocation of revenue between different jurisdictions. But there is another set of boundaries that is of major significance in any discussion of taxation: this consists of the boundary between illegal evasion and ‘legal’ avoidance and the boundary between what is sometimes termed ‘acceptable’ and ‘unacceptable’ avoidance.¹

There is a broad consensus among legislators around the world towards the need for cohesive anti avoidance strictures which differentiate between legitimate tax mitigation and tax avoidance. The introduction of GAAR, ideally, seeks to place curbs on tax avoidance without impinging on the right of the business to effectively mitigate the tax impact on its business within acceptable legal boundaries.

This point to a need for better legislation, giving clearer signals to taxpayers, better tools to the judiciary and an improved basis for enhanced cooperation between taxpayers, their advisers, and the tax authorities. Further work is clearly needed on forms of drafting, both at the specific and at the Meta levels. Such work should try to move beyond boundaries and towards tackling the underlying issues.²

¹ Beyond Boundaries : Developing Approached to Tax Avoidance and Tax Risk Management, Oxford University CBT

² Beyond Boundaries : Developing Approached to Tax Avoidance and Tax Risk Management, Oxford University CBT
The implementation of GAAR around the world has not been without its fair share of challenges; countries such as Canada, Australia, and South Africa have had previous experience dealing with a set of anti avoidance rules. Their experience suggests that GAAR does not provide an easy solution. However, most importantly, none of the jurisdictions have backed down despite setbacks but have rather come back with newer and stronger versions of the guidelines wherever the original plans have been defeated.

The only true solution to avoidance is to have a much more principle-based tax system which allows taxpayers to operate with a level of certainty that is required for businesses to function and grow.

**GAAR In Other Countries**

As discussed earlier, the global experience with GAAR has been mixed, at best. Australia explored the concept of GAAR as early as 1981, John Howard, who would go on to become the prime minister of the country, introduced the concept in his capacity as the federal treasurer. The measures proposed sought to curb down on arrangements which were termed “blatant” and “artificial”, seeking to counter schemes where it could be concluded, with due respect to its surrounding circumstances, that the scheme was entered into for the sale and dominant purpose of obtaining a tax benefit.

Canada was one of the first countries to explore the concept by means of explanatory notes issued in 1988 which laid down the rules governing abusive tax avoidance transactions. The guidelines stated that their intention was not to interfere with legitimate commercial and family transactions but rather to curb avoidance transactions which were defined as transactions which would result in a direct or indirect tax benefit or form part of a series of transactions which would result in tax benefits. However, transactions which serve legitimate business purposes are not considered avoidance transactions.

Similarly, South Africa, and China have enacted counter tax avoidance proposals which seek to curb upon the aggressive use of tax havens for the explicit avoidance of taxes, and transactions whose sole purpose is to avoid taxes. Among other transactions, Round tripping, accommodating parties and difference between legal substance of arrangement and legal substance is individual steps have been identified as events indicative of tax avoidance.

The United Kingdom has also looked into the setting up of a similar stricture and a draft legislation has been published which is slated to come into effect from April 2013. The proposed UK GAAR is much narrower in its scope and implication than the other jurisdictions as discussed earlier, the aim being "to deter and counter abusive tax avoidance, while providing certainty, retaining a tax regime that is attractive to businesses, and minimising costs for taxpayers and HMRC".

It is certainty, that is of the utmost import when it comes to structuring the businesses of this globalized era and therefore it is critical that the tax regimes in jurisdictions that a business operates in provide that certainty in the form of a stable rules based regime to its current and potential taxpayers.

---

3 Beyond Boundaries : Developing Approached to Tax Avoidance and Tax Risk Management, Oxford University CBT
Experiments With GAAR In India

The grounds for debate were established by two landmark cases namely, Azadi Bachao Andolan Vs Union of India which further relied upon the case of Duke of Westminster (19 TC 420) settled in the courts of the United Kingdom. The later laid down the position with respect to avoidance and evasion of taxes which was then upheld by the Indian judiciary during the course of the former. The courts created a clear demarcation between Tax Evasion which was illegal and Tax Avoidance which, though was undesirable, but was strictly within the confines of the law and therefore could not be clamped down upon.

The case of Vodafone International Holding BV v Union of India was perhaps the tipping point for the enactment of the GAAR provisions which had been first proposed as part of the New Direct Tax Code (“DTC”) in 2009.

The Indian GAAR as initially proposed and then enacted in 2012, albeit with minor modifications, the proposed provisions were much broader in their scope as compared to other jurisdictions around the world and even cover transactions which have a non tax avoidance motive, as long as one of the main purposes or outcomes of the transactions is to obtain a tax benefit. A tax benefit is described as a reduction or avoidance or deferral of tax as a result of the tax treaty. Therefore a transaction which provides a tax benefit and which satisfies certain specified conditions would be qualified as an impermissible avoidance agreement and would be subject to the implication of GAAR.

Impact

The draft guidelines as proposed by the government, earlier proposed to come into effect from 1st April 2013 were liberally interspersed with ambiguous terms and conferred a wide range of discretionary powers on the tax authorities without any safeguards being built in to protect the interests of the taxpayers.

In addition, concerns have been voiced over the ambiguity in the draft guidelines. The draft contained several terms which are ambiguous in their meaning and did not provide definitions, scope, or analysis of their meaning with respect to these provisions. Terms such as “Bonafide purpose” “Direct and indirect” and “Misuse and Abuse” have not been described making it difficult for the taxpayers to make concrete decisions with respect to their Indian operations. Further, the situation was compounded by the illustrations which lacked clarity with respect to interpretation and implications of the proposed guidelines. It became apparent that the draft was going to make life difficult for foreign funds, even those with perfectly legitimate structures. FIIs and their sub accounts would have run the risk of denial of treaty benefits in India unless tests of economic substance could be satisfied by the offshore entities.

It was perceived that the guidelines were drafted without adequate consultation with the stakeholders and that the rules, as they were framed, were too strict. It was under such circumstances that foreign funds voted with their feet and withdrew a large chunk of capital from India; dissent was also voiced by resident taxpayers and tax experts alike. Facing a certain backlash the government constituted an Expert Committee on General Anti Avoidance Rules (GAAR) to undertake stakeholder consultations and finalise the guidelines for GAAR after widespread consultations to ensure greater clarity on GAAR issues.
# Report of the Expert Committee on GAAR

The draft report of the expert committee was released on the 1st of September 2012, after examining the responses to the draft a final report was submitted by the committee on the 30th of September. On the 14th of January 2013, the honourable Finance minister issued a press statement accepting most of the major recommendations of the committee, albeit with some modifications. The recommendations and their status is discussed below in greater detail.

<table>
<thead>
<tr>
<th>S.No</th>
<th>As Per Finance Act, 2012</th>
<th>Expert Committee Recommendation</th>
<th>Status as on 15th January 2013</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>GAAR will be applicable from 1st April, 2014 (AY 2014-2015)</td>
<td>The implementation of GAAR may be deferred by three years on administrative grounds.</td>
<td>Implementation of GAAR deferred by 2 years.</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>The Government should abolish the tax on gains arising from transfer of securities which are subject to securities transaction tax (STT), whether in the nature of capital gains or business income, for both residents as well as non-residents</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Any arrangement, the main purpose or one of the main purpose of which is to obtain tax benefit.</td>
<td>The Act should be amended to provide that only arrangements which have the <strong>main purpose</strong> (and not one of the main purposes) of obtaining tax benefit should be covered under GAAR</td>
<td>Accepted</td>
<td>A tighter definition. If tax benefit is only one of the reasons, the transaction should not be held to be impermissible</td>
</tr>
<tr>
<td>4.</td>
<td>Section 97 of the Act should be amended to include a definition of <strong>“commercial substance”</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>The definition of <strong>“connected person”</strong> may be restricted to <strong>“Associated person”</strong> under section 102 and <strong>“associated enterprise”</strong> under section 92A.</td>
<td>The two separate definitions in the current provisions, namely, „associated person” and „connected person” will be combined and there will be only one</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

**Arkay & Arkay | Chartered Accountants**

**Delhi | +91 11 2735-7350 | info@arkayandarkay.com**
### 6.
Following factors should not be taken into account for determining substances:

i. Period for which the arrangement existed.
ii. Actual payment of taxes
iii. Exit route provided by arrangement

The section 97(2) may be amended to provide that the following factors:

i. the period or time for which the arrangement exists;
ii. the fact of payment of taxes, directly or indirectly, under the arrangement;
iii. The fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement,

Are relevant but may not be sufficient to prove commercial substance

**Accepted**

The assessing officer can't factor in these while invoking GAAR, but the approving panel can consider them.

### 7.
A minimum of three members:

Two commissioners of income tax and one official of the level of joint secretary or above from the Indian Legal Service.

Constitution of the Approving Panel (AP), the Committee recommends that –

a. The Approving Panel should consist of five members including Chairman;
b. The Chairman should be a retired judge of the High Court;
c. Two members should be from outside Govt. from the fields of accountancy, economics or business, with knowledge of matters of income tax; and
d. Two members should be Chief Commissioners of income tax; or one Chief Commissioner and one Commissioner

e. Appropriate mechanism may be provided to ensure confidentiality of information of the taxpayer becoming available to the members outside the Government.

The Approving Panel shall consist of:

a. A chairperson who is or has been a judge of High Court.
b. One member of the Indian Revenue Service not below the rank of Chief Commissioner of Income Tax; and
c. One member who shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and international trade practices.

**Should provide independence on account of inclusion of a judge and provide balance on account of presence of expert.**
Where anti-avoidance rules are provided in a tax treaty in the form of limitation of benefit (as in the Singapore treaty) etc., the GAAR provisions should not apply overriding the treaty.

**RECOMMENDATION TO BE PRESCRIBED AS PART OF INCOME TAX RULES**

1. The GAAR provisions should be subject to an overarching principle that –

   (1) Tax mitigation should be distinguished from tax avoidance before invoking GAAR.
   (2) An illustrative list of tax mitigation or a negative list for the purposes of invoking GAAR, as mentioned below, should be specified-
   (i) Selection of one of the options offered in law. For instance –
     (a) payment of dividend or buy back of shares by a company
     (b) setting up of a branch or subsidiary
     (c) setting up of a unit in SEZ or any other place
     (d) funding through debt or equity
     (e) purchase or lease of a capital asset
   (ii) Timing of a transaction, for instance, sale of property in loss while having profit in other transactions
   (iii) Amalgamations and

These principles would have ensured that GAAR was primarily rules driven and would have been able to give investors more confidence.
demergers (as defined in the Act) as approved by the High Court.

(3) GAAR should not be invoked in intra-group transactions (i.e., transactions between associated persons or enterprises) which may result in tax benefit to one person but overall tax revenue is not affected either by actual loss of revenue or deferral of revenue.

(4) GAAR is to be applicable only in cases of abusive, contrived and artificial arrangements.

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>No specific provision.</td>
<td>A monetary threshold of Rs 3 crore of tax benefit (including tax only, and not interest etc) to a taxpayer in a year should be used for the applicability of GAAR provisions. In case of tax deferral, the tax benefit shall be determined based on the present value of money.</td>
</tr>
</tbody>
</table>

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>No specific grandfathering. Investments made before announcement of GAAR not protected.</td>
<td>All investments (though not arrangements) made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on exit (sale of such investments) on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit. Only investment made before 30, August 2010 will be grandfathered. If investments are made after the grandfathering date, they will be subject to imposition of GAAR if the exits are made after the date on which GAAR comes into effect.</td>
</tr>
</tbody>
</table>

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>No specific Exclusion from GAAR where SAAR also exist.</td>
<td>Where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/element. Where GAAR and SAAR are both in force, only one of them will apply to a given case, and guidelines will be made regarding the applicability of one or the other.</td>
</tr>
</tbody>
</table>

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>No specific provision for FII. Provisions in the</td>
<td>The Foreign Institutional Investor (FII) is the taxable unit for taxation in India. Accordingly, the FIs do no enjoy any advantage under domestic law with respect to</td>
</tr>
</tbody>
</table>
treaty will not be applicable if GAAR invoked. And no specific provision in relation to non-resident investor in FIIs.

Committee makes the following recommendations-
(a) Where an FII chooses not to take any benefit under an agreement entered into by India under section 90 or 90A of the Act and subjects itself to tax in accordance with domestic law provisions, then, the provisions of Chapter X-A shall not apply to such FII;
(b) All investors above the FII stage should be excluded from the purview of GAAR as otherwise it may result in multiple taxation of the same income.

Whether an FII chooses or does not choose to take a treaty benefit, GAAR provisions would not be invoked in the case of a non-resident who has invested, directly or indirectly, in the FII i.e. where the investment of the non-resident has underlying assets as investments made by the FII in India. Such non-residents include persons holding offshore derivative instruments (commonly known as Participatory Notes) issued by the FII.

| 6. | No limit on the tax consequence. Would have extended to the entire arrangement even if only a part was impermissible. | Where only a part of the arrangement is impermissible, the tax consequences of an impermissible avoidance arrangement will be limited to that portion of the arrangement | Accepted | This is a welcome move and will prevent undue scrutiny of legitimate operations by imposition of GAAR on impermissible deals. |
| 7. | While determining the tax consequences of an impermissible avoidance arrangement, corresponding adjustment should be allowed in the case of the same taxpayer in the same year as well as in different years, if any. However, | | | |
no relief by way of
corresponding adjustment
should be allowed in the case of
any other taxpayer.

| 8. | Assessing officer has to inform to the commissioner before invoking GAAR. Commissioner to issue notice to assessee to make submission. | A requirement of detailed reasoning by the Assessing Officer in the show cause to the taxpayer may be prescribed in the rules | Assessing officer will be required to issue a show cause notice, containing reasons before invoking the provisions of GAAR |
| 9. | No specific provision for reporting of impermissible transactions by auditors. | The tax audit report may be amended to include reporting of tax avoidance schemes above a specific threshold of tax benefit of Rs. 3 crores or above | The Tax Auditor will be required to report any tax avoidance arrangement. Likely to lead higher compliance costs and differences of opinion between auditors and taxpayers. |
| 10. | The following statutory forms need to be prescribed:- a. For the Assessing Officer to make a reference to the Commissioner u/s 144BA(1) (Annexe-8) b. For the Commissioner to make a reference to the Approving Panel u/s 144BA(4) (Annexe-9) c. For the Commissioner to return the reference to the Assessing Officer u/s 144BA(5) (Annexe-10) | | Accepted with modification: Forms yet to be prescribed |
| 11. | No specific time limit, except for directions by approving panel. | The following time limits should be prescribed that - i) in terms of section 144BA(4), the Commissioner (CIT) should make a reference to the Approving Panel within 60 days of the receipt of the objection from the assessee with a copy to the assessee; ii) in the case of the CIT accepting the assessee objection and being satisfied that provision of Chapter X-A are not | Accepted with modification: Time limit yet to be provided for actions of various authorities. |
applicable, the CIT shall communicate his decision to the AO within 60 days of the receipt of the assessee objection as prescribed under section 144BA(4) read with section 144BA(5) with a copy to the assessee.

iii) No action u/s 144BA(4) or 144BA(5) shall be taken by the CIT after a period of six months from the end of the month in which the reference under sub-section 144BA(1) was received by the CIT and consequently GAAR cannot be invoked against the assessee.

RECOMMENDATIONS TO BE IMPLEMENTED VIA CIRCULAR

1. GAAR shall apply only to the income received, accruing or arising, or deemed to accrue or arise, to the taxpayers on or after the date GAAR provisions come into force. In other words, GAAR will apply to income of the previous year, relevant to the assessment year in which GAAR becomes effective and subsequent years.

2. Where Circular No. 789 of 2000 with respect to Mauritius is applicable, GAAR provisions shall not apply to examine the genuineness of the residency of an entity set up in Mauritius.

3. When the AO informs the assessee in his initial intimation invoking GAAR, he should include how the factors listed in section 97(2) have been considered (after amendment as recommended).
<table>
<thead>
<tr>
<th>OTHER RECOMMENDATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.</strong> The administration of Authority for Advance Ruling (AAR) should be strengthened so that an advance ruling may be obtained within the statutory time frame of six months. Accepted with modification: No Time frame is mentioned. It states; sec 245N(a)(iv) that provides for an advance ruling by the Authority for advance ruling whether an arrangement is an impermissible avoidance arrangement will be retained and the administration of the AAR will be strengthened.</td>
</tr>
<tr>
<td><strong>2.</strong> Until the abolition of the tax on transfer of listed securities, Circular 789 of 2000 accepting Tax Residence Certificate (TRC) issued by the Mauritius authorities may be retained.</td>
</tr>
<tr>
<td><strong>3.</strong> While processing an application under section 195(2) or 197 of the Act, pertaining to the withholding of taxes, (a) the taxpayer should submit a satisfactory undertaking to pay tax along with interest in case it is found that GAAR provisions are applicable in relation to the remittance during the course of assessment proceedings; or (b) in case the taxpayer is unwilling to submit a satisfactory undertaking as mentioned in (a) above, the Assessing Officer should have the authority with the prior approval of Commissioner, to inform the taxpayer of his likely liability in case GAAR is to be invoked</td>
</tr>
</tbody>
</table>
during assessment procedure.

4. To minimize the deficiency of trust between the tax administration and taxpayers, concerted training programmes should be initiated for all AO's placed, or to be placed, in the area of international taxation, to maintain officials in this field for elongated periods as in other countries, to place on the intranet details of all GAAR cases in an encrypted manner to comprise an additive log of guidelines for future application.

<table>
<thead>
<tr>
<th>Change In GAAR without recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Directions of AP binding only on assessing officer. Assessee could have filed appeal to ITAT (the income tax appeals body)</td>
</tr>
</tbody>
</table>

**Implementation Issues**

The expert committee has cited several issues and concerns that have been expressed with respect to implementation of GAAR. Some of the reasons cited include:

- Deficiency of trust between tax administration and taxpayers;
- Anticipated attempts to invoke GAAR in a general manner, if not in every possible case;
- Lack of accountability in the manner in which tax officers conduct business, and for its outcome;
- Fear of audit by C&AG;
- Compulsion for tax officers to meet budget targets;
- Past experience in implementing regulations pertaining to transfer pricing which gave little confidence, according to them, in fair and appropriate implementation;
- Advance ruling not being obtained in the specified period of six months.⁴

---

⁴ Final Report of Expert Committee on GAAR pg 58-59
**FACTS**

Indian co. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) in F.Y. 2013-14 for manufacturing and selling its products. It claims 100% deduction of profits earned from that unit in F.Y. 2013-14 and subsequent years as per section 10AA of the Act.

**OPINION**

The tax benefit that will accrue on account of setting up unit in SEZ is a case of tax mitigation where the tax payer is taking advantage of a fiscal incentive offered to him by submitting to the conditions and economic consequences of the provisions in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue should not invoke GAAR with respect to this arrangement.

**FACTS**

Indian co. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) and but transfers the product of non-SEZ unit at a price lower than the fair market value, reflecting only negligible activity in SEZ unit therefore transferring its profits to the SEZ unit.

**OPINION**

Such tax avoidance would be countered with SAAR in the form of TP regulations and since it does not involve fraud and misrepresentation it would not amount to tax evasion. Hence, the Revenue should not invoke GAAR in such a case.
FACTS

An Indian co. has set up a holding company in a Non Tax jurisdiction (NTJ) which has set up subsidiaries in NTJ (Sub 1 and 2) which pay dividends to the holding co. The holding co. pays no dividends to Indian Co.

OPINION

No GAAR would be applicable as declaration or non declaration of dividend is the prerogative of a company. India does not possess anti-deferral provisions in the form of Controlled Foreign Company (CFC) rules in the I.T. Act and therefore GAAR cannot be imposed.

FACTS

If the holding co. in the illustration merges into the Indian co. along with the accumulated dividend from Sub1 and Sub 2, would GAAR be invoked?

OPINION

Section 47 of the Income Tax Act specifically exempts capital gains on the cross border merger of the foreign company with an Indian company. Therefore GAAR cannot be imposed in such a circumstance.
FACTS

An Indian company claims deduction for lease rentals in case of acquisition of assets through lease, in contrast to depreciation that would be claimed as in the case of outright purchase of an asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?

OPINION

Since the Assessee is merely exercising its choice within acceptable legal boundaries. No provisions of GAAR should be applicable in this circumstance.
**FACTS**

An Indian co. has raised funds via the debt route instead of raising equity from a Foreign co. incorporated in a Non Tax Jurisdiction. What would be the repercussion in case:

- Zero or constant interest rates are applicable
- Interest is directly proportional to revenue

**OPINION**

- This should not cause constitute avoidance, since there are no specific provisions dealing with thinly capitalized companies in the act. An evaluation of whether a business should have raised funds through equity instead of debt is generally be left to commercial judgment of a taxpayer. Therefore in the first circumstance GAAR should not be attracted

- The calculation of interest in the manner of dividend reflects an arrangement whose main purpose is to obtain a tax benefit by claiming actual dividend payment as interest payment. Therefore the provisions of GAAR will be attracted.
FACTS

Indian Co. incorporates a Subsidiary Co. in a non tax jurisdiction with equity of USD 1 million. The subsidiary company has no business activities and therefore no reserves, it furnishes a loan, for business purposes, of USD 1 million to the Indian Co. on which interest is payable at the rate of 10% per annum. The Indian Co claims deduction of interest payable to Subsidiary co from business profits.

OPINION

In the eyes of the tax authorities, the primary purpose of this arrangement shall be construed to be to obtain interest deduction in the hands of Indian co. and thereby tax benefit. There seems to be no commercial substance in establishing Subsidiary co. since there is no effect on the business risk or cash flow, apart from the tax benefits, of the Indian co.

Therefore GAAR will be applicable.

FACTS

A large corporate group, based in a non tax jurisdiction, has created a services company in India to manage its non core functions. The services company then charges the holding company for the services rendered at a cost plus basis.

OPINION

The transactions in this case will be governed by specific anti avoidance provisions (SAAR) in the form of Transfer pricing regulations. Therefore in our opinion, GAAR should not be applicable.
FACTS

Holding co. is a company incorporated in the UK and is a non resident as per the act. Holding company invests in investing company which is a resident of a non tax jurisdiction. There is no business activity being carried out by Investing co. All rights of voting, management, right to sell etc. are vested by investing company with Holding co.

Investing company further invests in 49% equity of a Indian JV company, namely Indian Co. With the remaining 51% being invested by Partner Company, which is also a company incorporated in India.

Later the shares of the Indian co. are sold to Buyer Co. a Indian company which is a group company of Partner Co.

OPINION

Since there is no business purpose in incorporating Investing co. in a non tax jurisdiction, it can be suggested that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment by Holding Co. in the joint venture. The tax benefit would be the difference in tax liabilities between the two available courses.

Further since all rights of investing co. are vested with the holding co. it is evident that there is no commercial substance in incorporating A Ltd therefore GAAR may be invoked by the tax authorities.
FACTS

The shares of Asset Co, an asset owning Indian company, are held by another Indian company Indian Co. Indian Co., in turn, is held by two companies Holding Co. Partner Co., incorporated in a Non tax Jurisdiction. The tax treaty provides for non-taxation of capital gains in the source country and NTJ charges no capital gains tax in its jurisdiction. Indian Co. is liquidated by consent of shareholders resulting in transfer of the asset/shares from Indian Co. to Holding Co and Partner Co.

Subsequently such shares in Asset Co are sold by Holding and Partner Cos to Purchasing Co. also incorporated in the NTJ.

Holding Co and Partner Co. claim treaty benefits and the resultant gains from the transaction are claimed to be not taxable.

OPINION

This transaction can be effected in one of several ways, being:

1. As effected
2. Sale of shares in Indian Co. by Holding and Partner Co. to Purchasing Co.
3. Sale of Shares in Asset Co. by Indian Co. to Purchasing Co.

In Option 1 and option 2, there should not be any tax liability in India except taxation of Deemed dividend to the extent of available free reserves in Indian Co. at the time of liquidation (Option 1).

There shall be a tax liability in the hands of the Indian Co. in Option 3, upon the sale of Asset Co. to Purchasing co.

Based on the recommendations of the expert committee report, there should not be any imposition of GAAR as the tax payer is only exercising his options in the most tax efficient manner.
The future of GAAR: Closing Remarks

As it is around the world, it is evident that GAAR is here to stay in India. However in light of the tumultuous relationship between the tax authorities and the taxpayers it needs to be ensured that instead of a broad scoped instrument for harassment, GAAR becomes a narrow focussed tool for the specific checking of aggressive tax avoidance schemes.

While the Finance Minsters acceptance of some of the recommendations is a welcome step, more needs to be done to assuage and safeguard the interest of the legitimate investors in India. The relaxation in capital gains tax for example, will perhaps be notified as part of the upcoming budget to be presented in the near future. Similarly, the statement of the finance minister has not addressed the recommendation of the expert committee with respect to circular 789 and allowability of treaty benefits with respect to jurisdictions where the DTAA have inbuilt anti abuse provisions in the form of limitation of benefits (“LOB”) clauses.

A lot will depend on the implementation of GAAR, the government will need to undertake confidence building exercises to calm the fears with respect to GAAR. Interestingly, the chairman of the expert committee which prepared this report is now also the Advisor to the honourable Finance Minster. The upcoming budget will be interesting to say the least.
DISCLAIMER: This paper is a copyright of Arkay & Arkay, Chartered Accountants. No reader should act on the basis of any statement contained herein without seeking professional advice. The authors and the firm expressly disclaim all and any liability to any person who has read this paper, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance upon the contents of this paper.