GENERAL ANTI-AVOIDANCE ARRANGEMENT

GAAR

EFFECTS

Transactions that may be GAARed

1. Not only international transactions and cross border transactions but even the desi transactions could be brought under GAAR

2. GAAR applies to both personal and corporate taxation

3. The cases to come under GAAR are not exhaustive

4. GAAR could nullify the effect of court rulings without carrying amendment to tax provisions : Slump sale disguised as slump exchange to overcome Bharat Bijlee decision

Domestic transactions that may be GAARed

1. Debt restructuring like fresh loan to repay old loan and equity coloured as debt

2. Corporate restructuring

3. Revaluations followed by business acquisition

4. Private Trust where author is a beneficiary, sole or otherwise

5. Circuitous routes like cross gifts, cross transfers, cross perquisites

6. Executive salary planning like flexi pay, ESOP etc.

Crossborder transactions that may be GAARed

1. Non AE transactions
2. Routing of investments through low tax/no tax jurisdictions
3. Corporate tax inversions like Google, Starbucks, Apple, Fiat, Pfizer, Facebook
4. POEM determination
5. Overseas trusts

BASIC SCHEME

GAAR

Chapter X-A

Sections 95 to 102

- **Section 95** – Basic enabling provision
- **Section 96 & 97** – Impermissible Avoidance Arrangement (IAA)
- **Section 98** – Consequences
- 1. Sec 99 - Parameters for determining tax benefit
  2. Sec 100 -Provisions are in lieu of/in addition to
  3. Sec 101 -Guidelines & Conditions
  4. Sec 102- Definition
  5. Sec 144BA - GAAR assessment

NEED FOR

GAAR

Why GAAR? - Memorandum

1. The question of substance over form has consistently arisen in the implementation of taxation laws.

2. In the Indian context, judicial decisions have varied. While some courts in certain circumstances had held that legal form of transactions can be dispensed with and the real substance of transaction can be considered while applying the taxation laws, others have held that the form is to be given sanctity. The existence of anti-avoidance principles are based on various judicial pronouncements.

3. There are some specific anti-avoidance provisions but general anti-avoidance has been dealt only through judicial decisions in specific cases.

Why GAAR? - Memorandum

4. In an environment of moderate rates of tax, it is necessary that the ***correct tax base be subject to tax in the face of aggressive tax planning and use of opaque low tax jurisdictions for residence as well as for sourcing capital***.

5. Most countries have codified the ***"substance over form"*** doctrine in the form of General Anti Avoidance Rule (GAAR).

6. In the above background and ***keeping in view the aggressive tax planning with the use of sophisticated structures, there is a need for statutory provisions so as to codify the doctrine of "substance over form" where the real intention of the parties and effect of transactions and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure that has been superimposed to camouflage real intent and purpose***.

Why GAAR? - Memorandum

7. Internationally several countries have introduced, and are administering statutory General Anti Avoidance Provisions. It is, therefore, important that Indian taxation law also incorporates a statutory General Anti Avoidance Provisions to deal with aggressive tax planning.

SOME

RULINGS

Cases on GAAR

- Gains on sale of CCDs carrying no interest but only convertible into shares at different prices depending on period of holding are interest, taxable under article 11 and not capital gains under article 13.4 of Mauritius DTAA. This is especially so when issuer company is mere puppet of holding company and issuer company and holding company are one and same entity - 'Z' Mauritius, In re **[2012] 20 taxmann.com 91 (AAR - New Delhi) upset in TS-464-HC-2014 Delhi HC**

- Purchase of share at Rs.6 and sale at Rs.200 in 13 months time to fund a house and claiming exemption under sec 54F : CIT v. Jawahar

Cases on GAAR

- Off market transactions to make the loss coming from non exempt source [non 10(38)] cannot be dubbed as tax evasion : Mridu Hari Dalmia Parivar Trust 68 Taxmann.com 376 Dehli ITAT

- Assessee purchased shares from group company which were subsequently sold to the same group company at a loss, claiming urgency owing to huge tax demand, referring to tax payment challan evidencing payment during March 2009 to January 2010. ITAT approves CIT(A) order, holds assessee's transaction of purchase and sale of shares with group concern as sham and thus, disallows claim for short term capital loss : **[TS-57-ITAT-2016(DEL)]**

Cases on GAAR

- Assessee (a Jindal group company) renounced rights in PCDs in favour of another group company ('JSL') at a significantly lower price than market value resulting in significant loss; HC denies assessee's loss set-off claim, holds it is only a notional loss : **Abhinandan Investment Ltd. [TS-666-HC-2015(DEL)]**

- If the taxpayer is in a position to carry through a transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to do so effectively in the absence of any specific tax avoidance provision. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides : **Bhoruka Engineering Inds. Ltd. v. Dy. CIT [2013] 356 ITR 25 (Karnataka) HC**

Cases on GAAR

1. In *CIT and DCIT v. Wipro Limited* ITAs Nos. 1394 and 1395 of 2006, the assessee, Wipro Limited ("**Wipro**"), claimed various deductions and exemptions under the ITA. The issue before the Karnataka High Court was whether the capital loss claimed by Wipro against short-term capital gains could be challenged on the grounds that sale of shares of a related entity to persons who were employees of the Wipro group for a consideration lower than the market value was a colourable device to show capital loss.

2. **Copal Research Ltd. [2014] 226 Taxman 226 (Delhi – HC) on indirect transfer**

3. **Sanofi Pasteur Holdings SA 354 ITR 316 (AP) HC on beneficial ownership**

Cases on GAAR

1. HC sets aside AAR order holding gains from sale of equity shares & Compulsorily Convertible Debentures (CCDs) as “interest” taxable u/s 2(28A) and Article 11 of India-Mauritius DTAA and not as exempt capital gains in India : Zaheer Mauritius v. Director of Income-tax (International Taxation) – [TS-464-HC-2014(DEL)]

2. Rejects Revenue’s stand that excess payment over face value of equity shares so bought back was nothing but distribution of accumulated profits to its ultimate beneficiary/holding company and accordingly assessee was liable to deduct TDS u/s 195 on such deemed dividend income arising to Mauritian entity : **[TS-72-ITAT-2016(Mum)]**

Cases on GAAR

1. AAR rules that capital gains arising on proposed transfer of Indian group company's shares by applicant (a Mauritian company) to its Singaporean affiliate not taxable in India, grants India-Mauritius treaty benefit; AAR notes that for the purposes of group's operational excellence and administrative convenience, it was decided to shift shareholding of Indian arm from Mauritius to Singapore, accordingly it was proposed that a Singaporean entity be set-up by way of applicant contributing its India investment as capital; AAR rejects Revenue's stand that proposed transfer of shares amounted to a scheme of tax avoidance, holds that transfer "was clearly for the business considerations : [**TS-15-AAR-2016**]

Cases on GAAR

1. Dividend distribution to reduce capital gains tax is permissible, all transactions that lead to tax savings cannot be regarded as a colourable transaction : ACIT v. Maersk Line UK Ltd. 20 ITR – TRI 643

2. Sale of shares by Mauritius Co can be treated as sale by 100% USA parent so as to deny the benefit of Indo Mauritius DTA : Aditya Birla Nuvo Limited v342 ITR 308 Bby

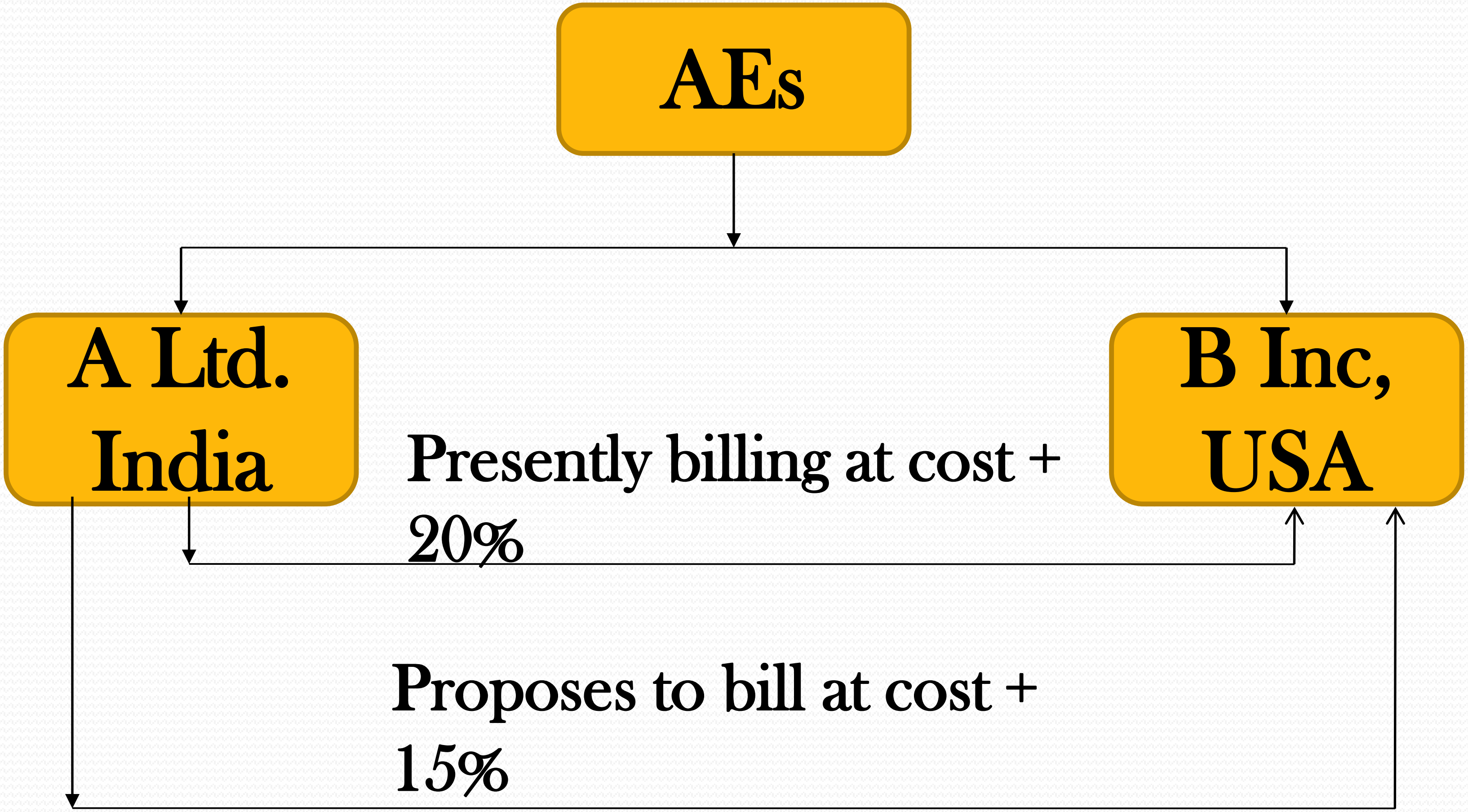
XYZ, In re [2012] 20 taxmann.com 89 (AAR)

- Only a genuine buyback is excluded from definition of 'dividend' by section 2(22)(iv) and exempt from DDT under section 115-O.

- A colorable transaction of buyback of shares will attract DDT.

- Where in view of finding that proposed buy-back is a colourable transaction, receipt of buyback consideration by A (Mauritius) will satisfy definition of dividend under Act and consequently attract tax in India

SOME EXAMPLES

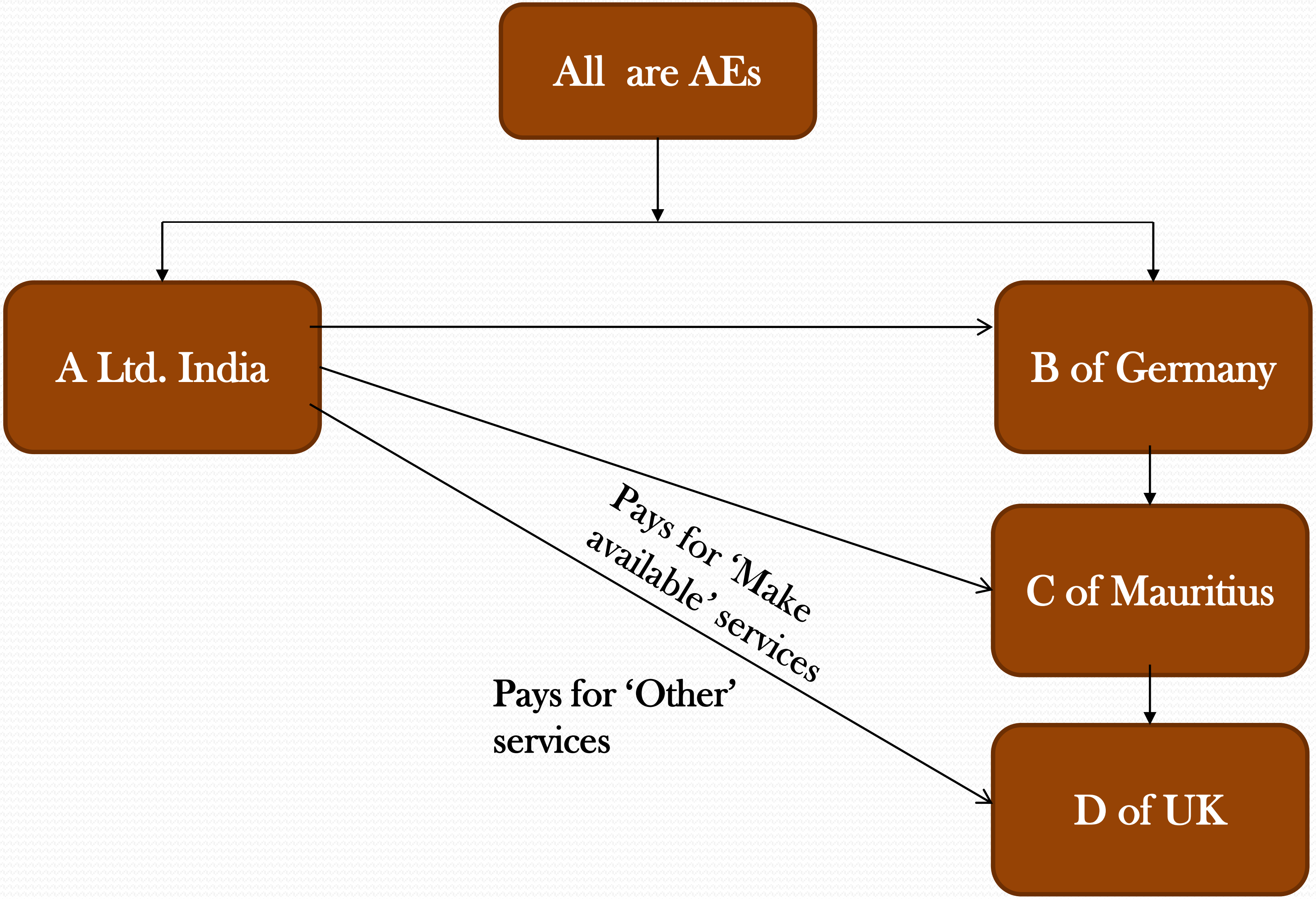

AEs
A Ltd. India
B Inc, USA
Presently billing at cost + 20%
Proposes to bill at cost + 15%

Notes

- If A & B were non A E s

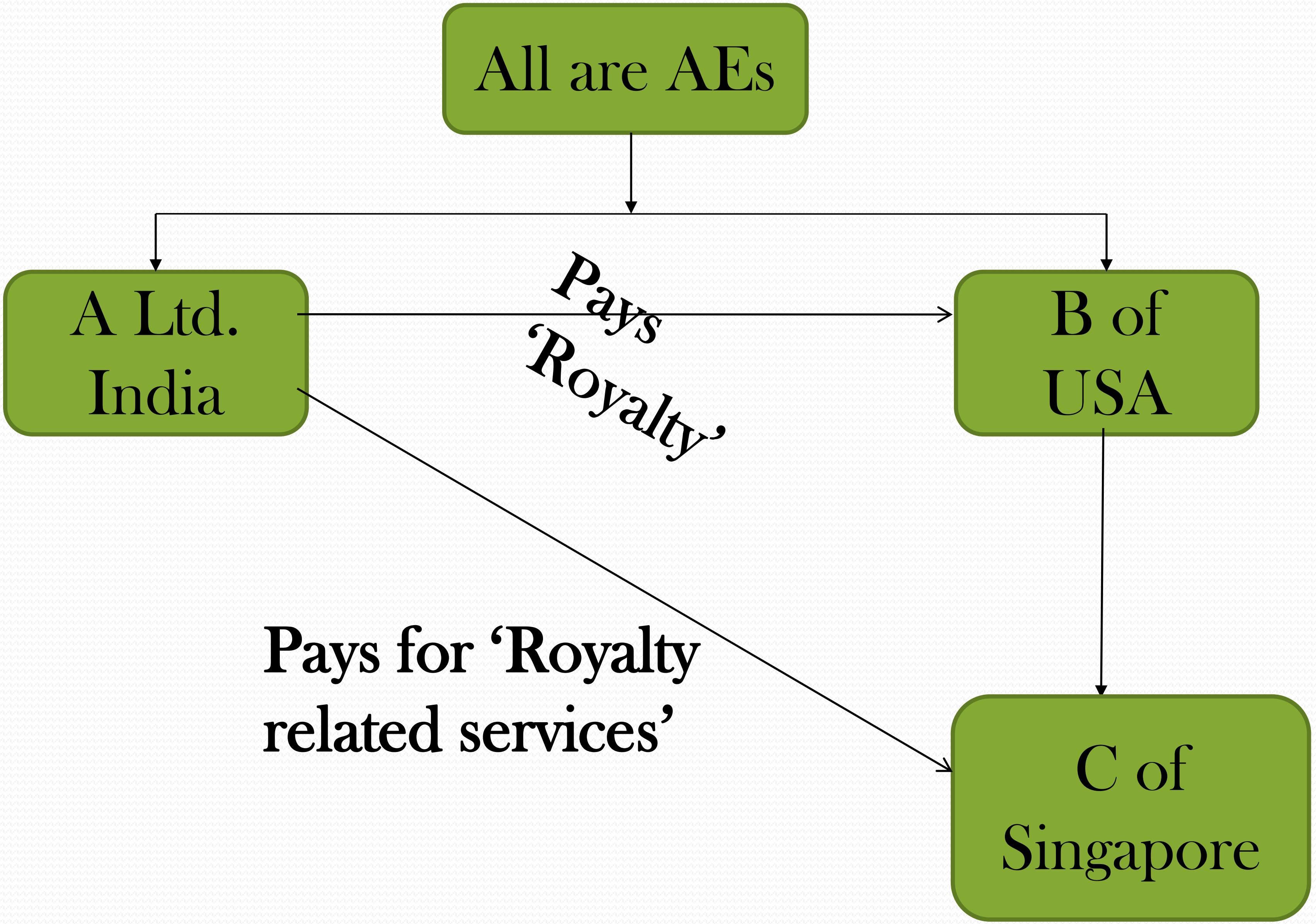
1. **TB to whom : Not to A but to B**

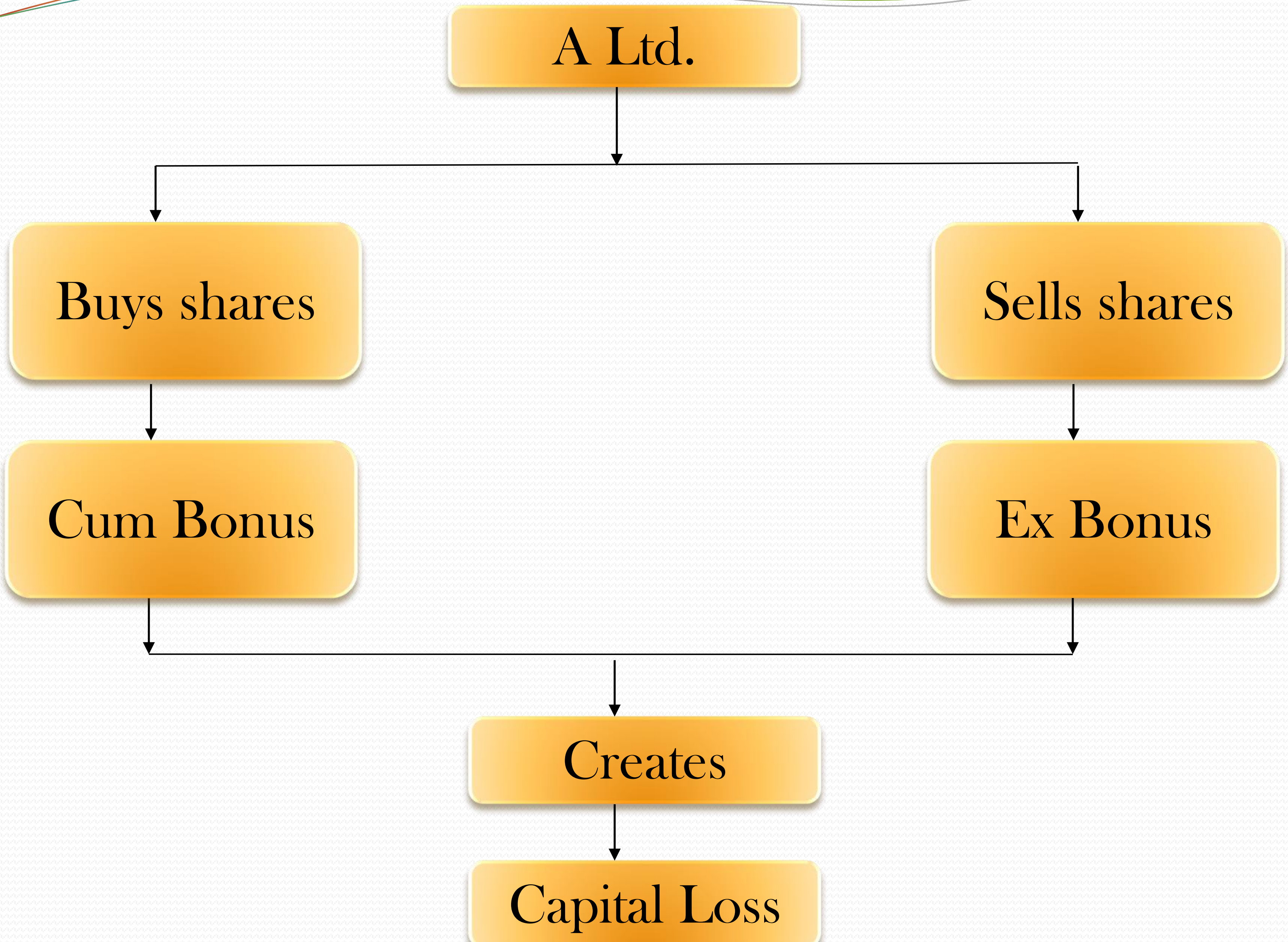
2. **If GAAR is invoked for A, no adjustment to B**


All are AEs
A Ltd. India
B of Germany
C of Mauritius
D of UK
Pays for 'Make available' services
Pays for 'Other' services

Notes

- Principles of AP7 of BEPS – Anti fragmentation
- **When A.Es, no GAAR in so far as ALP is concerned.**
- **However, GAAR could be used to treat C and D as accommodating parties which is not possible in TP regime.**
- **TB to A only when grossed up under sec 195A**

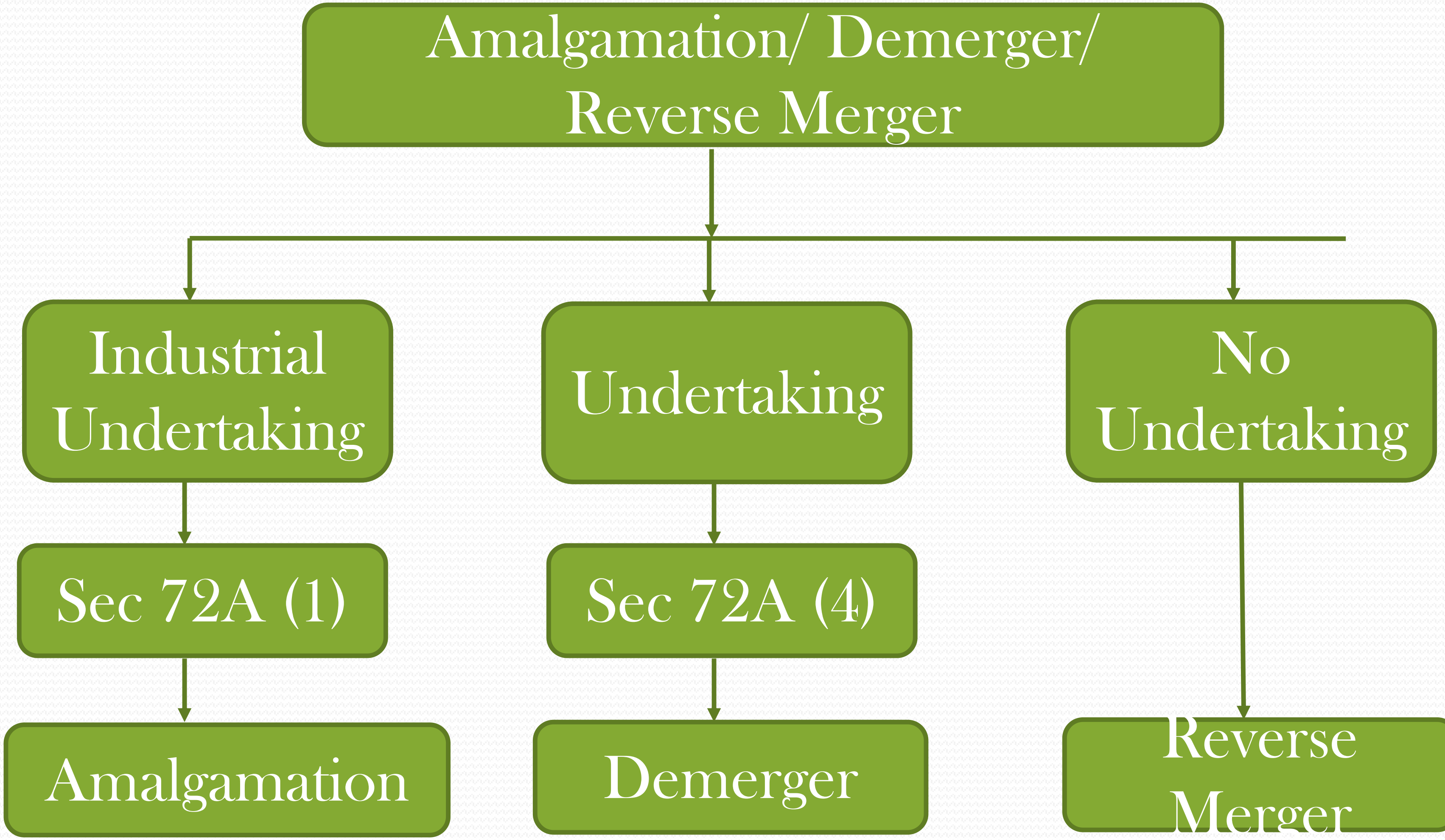

All are AEs
A Ltd. India
B of USA
C of Singapore
Pays 'Royalty'
Pays for 'Royalty related services'

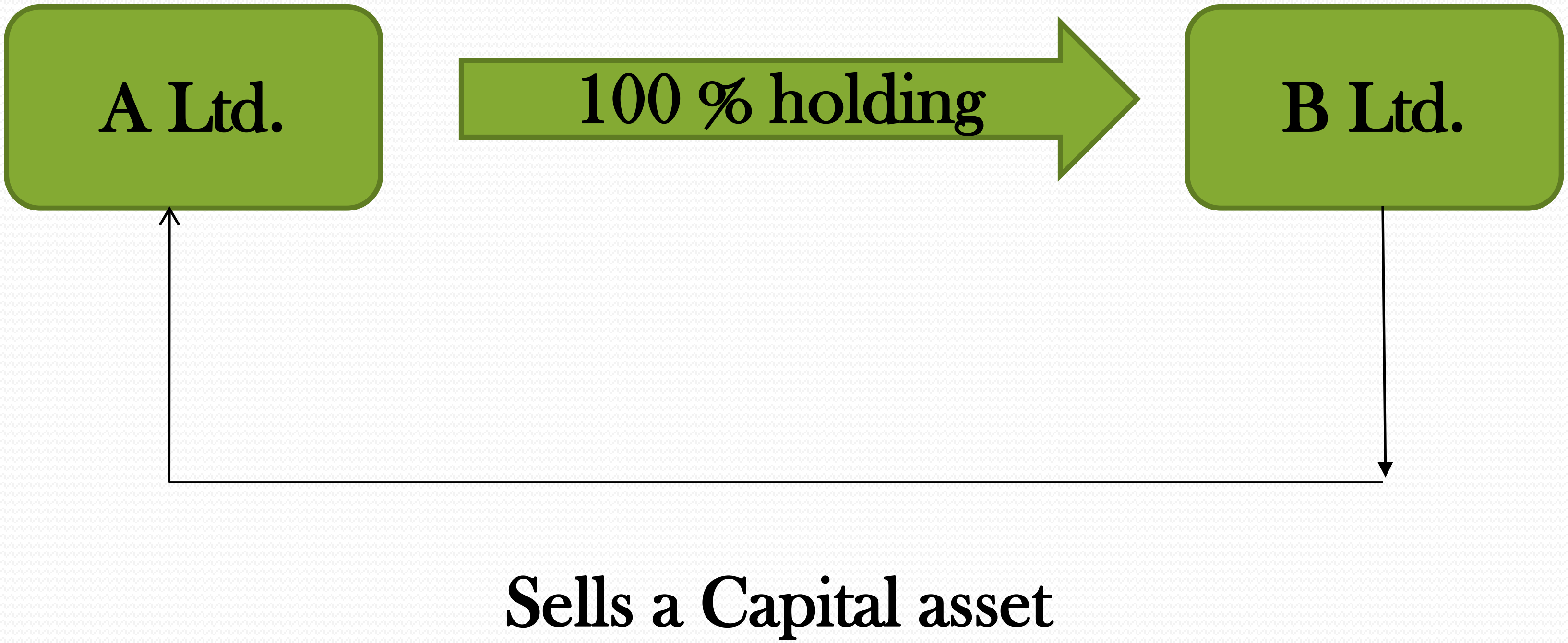

A Ltd.
Buys shares
Sells shares
Cum Bonus
Ex Bonus
Creates
Capital Loss

Notes:

1. Sec 94 (8) covers bonus stripping of units but not shares.

2. Use vs. Misuse – 326 ITR 1 (SC)


Amalgamation/ Demerger/ Reverse Merger
Industrial Undertaking
Undertaking
No Undertaking
Sec 72A (1)
Sec 72A (4)
Amalgamation
Demerger
Reverse Merger



BV = Re. 1

MV = Rs. 100 L

Transaction value = Rs. 50 L

Notes

- Transaction exempt under section 47(v)
- **However, in subsequent year, parties may violate the conditions to come under sec 47A.**
- **This would mean rectification in A's assessment to tax A in respect of capital gain not taxed earlier.**
- **Can GAAR be invoked as transaction value was taken as Rs.50L to hoodwink on interplay between 47(v) and 47A?**

Notes:

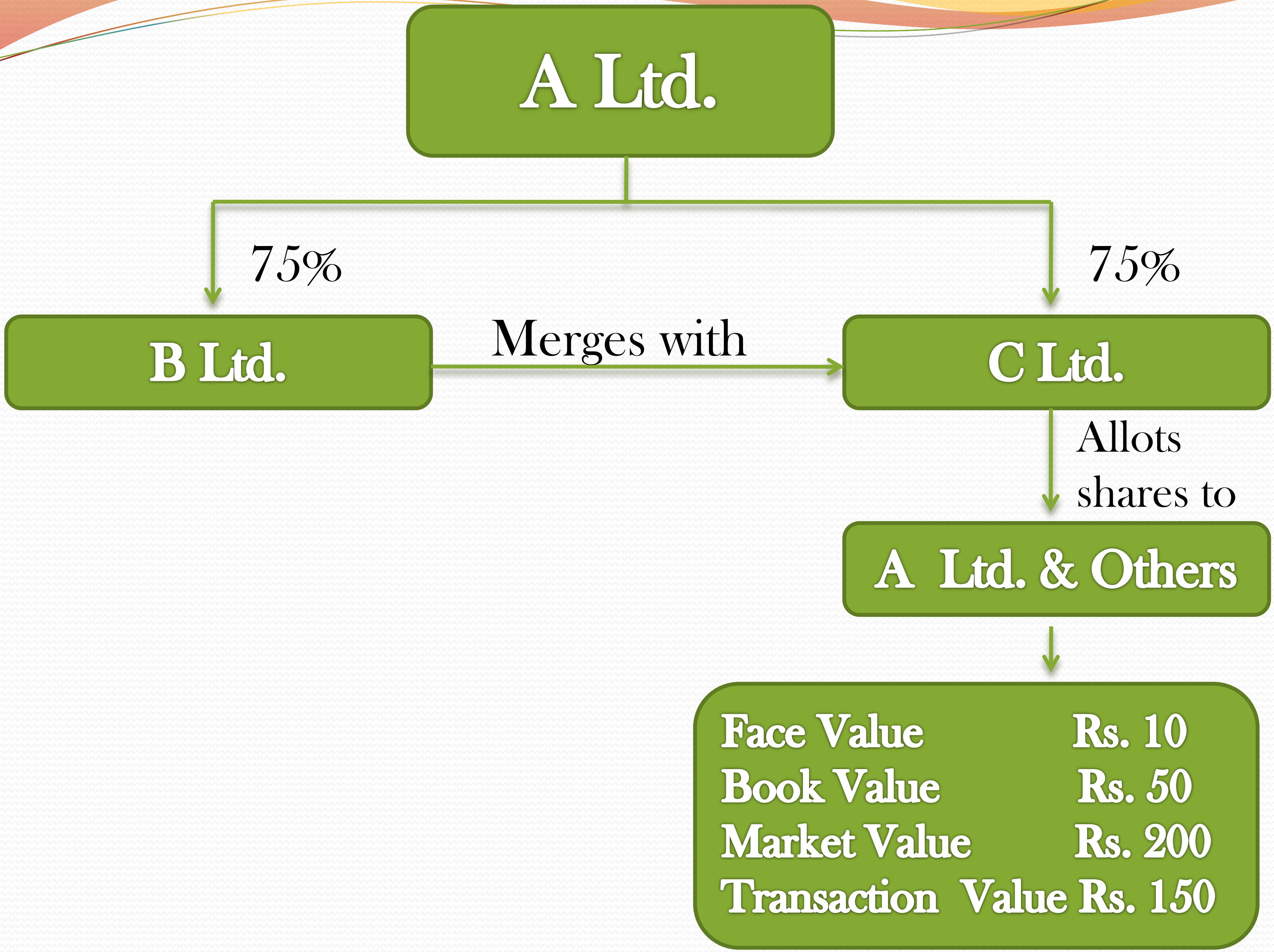
1. Is there a TB?

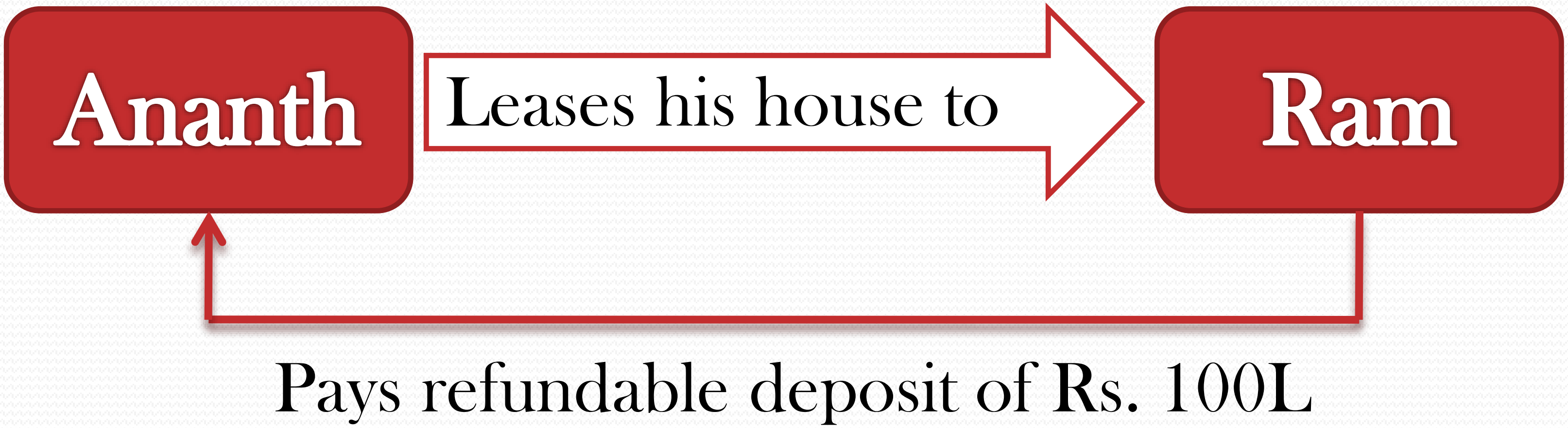
   - Sec 47 (v)

   - MAT vs. NT for STCG

   - MAT vs. NT for LTCG read with Sec 115JAA

2. Are conditions of Sec 96 (1) (a to d) met?


A Ltd.
75%
75%
B Ltd.
Merges with
C Ltd.
Allots shares to
A Ltd. & Others
Face Value Rs. 10
Book Value Rs. 50
Market Value Rs. 200
Transaction Value Rs. 150

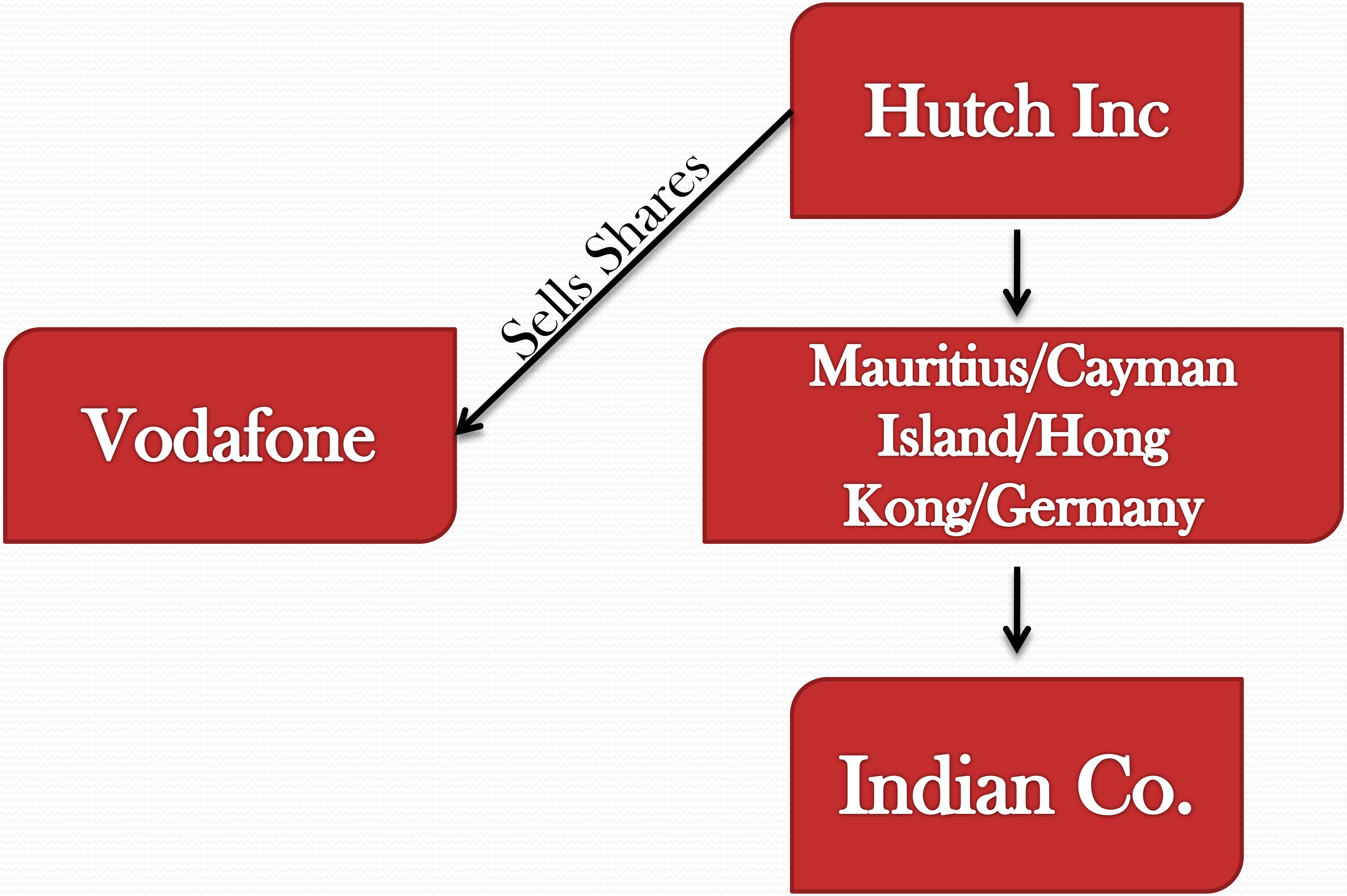


Notes:

1. Rent v. Refundable Deposit (RD)
2. Interest on RD v. Rent
3. What if RD is invested in tax free bonds?
4. Decisions of Delhi and Bombay HCs on interest on rental deposit
5. What if Land is leased

Other day to day instances

1. Purchase of windmill to claim (a) Depreciation at higher rate (b) Additional depreciation (c) Section 80-IA relief
2. Purchase of depreciable asset on 30th September or on 31st March
3. Sale cum lease back
4. Assessee seeking conversion under sec 47(xiii)/(xiiib)/(xiv) and subsequent dilution of 50%


Hutch Inc
Sells Shares
Vodafone
Mauritius/Cayman Island/Hong Kong/Germany
Indian Co.

Notes:

1. De hors Section 9 or if Explanations 4 & 5 are overcome

2. TB to whom?

3. Section 97(1)(c) is hit

4. Section 163 on Vodafone v. GAAR

5. TDS obligation of Vodafone v. GAAR on Hutch : Decision taken by revenue at a much later stage.

6. Is Vodafone buying a share an IAA?

In a US-India dual residency, where a PH is created in USA solely for becoming USA resident

Vs.

An Indian Company having POEM in Singapore thereby a dual resident under Article 4(1) but becoming a Singapore resident under Article 4(3)

Vs.

An Indian Company deliberately having POEM in Singapore thereby artificially creating a dual residency to eventually become non-resident under Article 4(3)

Service PE

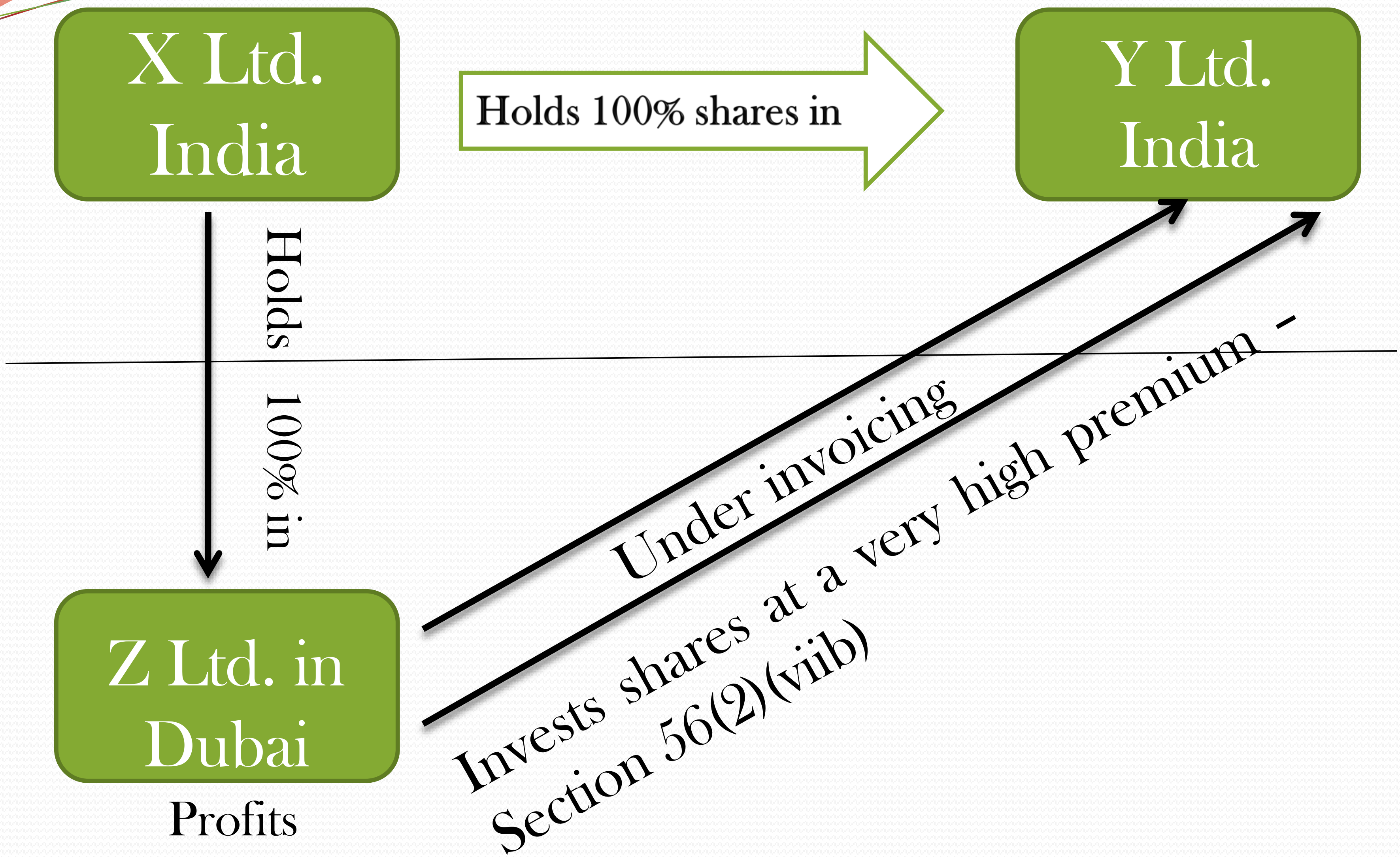
Installation PE

Fixed Base

Splitting the period between

Two fiscal year

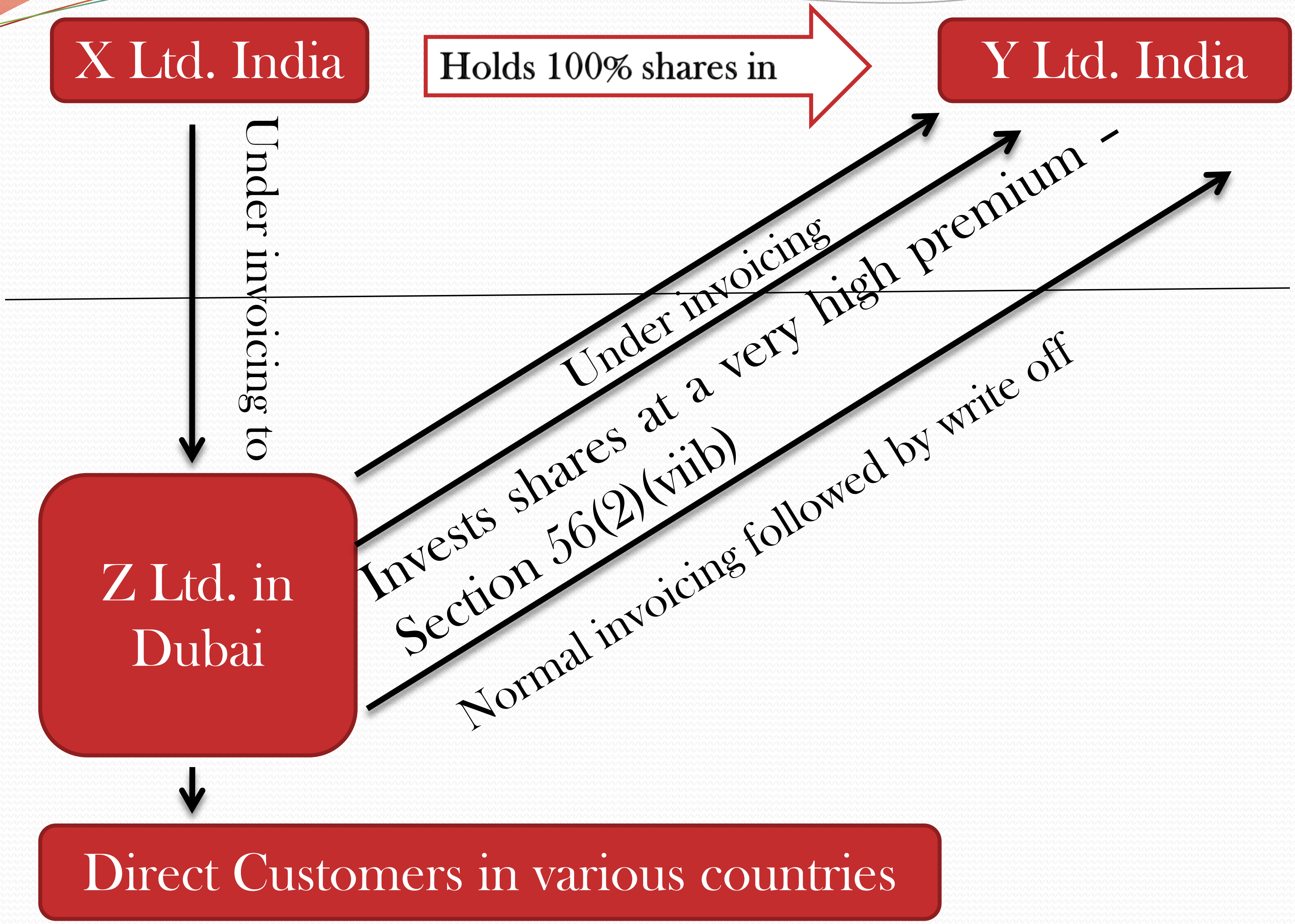
- Short stay exemption
  - Section 10(6)(vi)
  - Article 15(2)


X Ltd. India
Holds 100% shares in
Y Ltd. India
Holds 100% in
Under invoicing
Invests shares at a very high premium – Section 56(2)(viib)
Z Ltd. in Dubai
Profits

Notes:

1. Is it a case of RTF? Does X own cash of Z : 27 ITR 1 and 341 ITR 1 SC

2. Is Y Ltd. an AP?



X Ltd. India
Holds 100% shares in
Y Ltd. India
Under invoicing to
Under invoicing
Invests shares at a very high premium - Section 56(2)(viib)
Normal invoicing followed by write off
Z Ltd. in Dubai
Direct Customers in various countries

Notes

- Clear case of RTF
- See Examples 6 & 7 of Shome Final report

GAAR

IN OTHER

STATES

GAAR in other States : About 30 countries have GAAR

France	Isreal
Australia	Singapore
Canada	Russia
New Zealand	Spain
South Africa	Sweden
UK	Denmark
Belgium	Portugal
Austria	Poland
Cyprus	Brazil
China	Malaysia
Hong Kong	Luxembourg
Switzerland	Ireland
Turkey	Korea

USA

USA : IRS Notice 2010-62 providing for application of codified economic substance doctrine [ECS doctrine]

The ECS doctrine permits the tax authorities to deny tax benefits from a transaction unless

a) The transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position

b) The taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into the transaction

Germany

Germany: On 25.02.2012, the Ministry of Finance published official guidance (IV B 3-S 2411/07/10016) on the application of the anti-treaty-shopping rules embodied in Article 50d(3) of the IT Act as amended in 2011.

- Under the revised rules, treaty benefits to a non-resident (intermediate) company are denied if:

1. As far as its shareholders would not be entitled to the treaty benefits if they would have invested directly; and
2. As far as the functional requirements of Article 50d(3) are not fulfilled, i.e., the company derives harmful revenue.

Germany

The functional requirements are met if:

1. As far as the company generates its gross income from its own active business activities; or

2. In regard to the company's gross income that is not generated from its own business activities

   a) There are economic or other important reasons for the use of the international company in view of the respective income and

   b) The foreign company is adequately equipped for carrying out its own business activities and for participating in the general commerce.

GAAR in other States

- South Africa –2006 GAAR introduced appears to have been the inspiration behind Indian provisions
- Netherlands and Canada –Burden of proof on the tax authorities
- Australia –Application determined on the basis of 8 test or factors

GAAR Philosophy

GAAR : Sources for interpretative principles

- Memorandum
- Finance Minister's assurance
- Standing Committee Recommendations on DTC
- Shome Committee on GAAR
- Court rulings

GAAR : Interpretative principles

- Tax mitigation v. Tax evasion v. Tax avoidance

- Negative list [illustrative] of tax mitigations where GAAR should not apply

1. Choice of legal options
2. Timing of transaction
3. Corporate restructuring blessed by courts

- GAAR not to apply to intra group transactions where the tax effect is neutral within the group

GAAR : Interpretative principles

- Even for cases of tax avoidance, GAAR should be applied only to abusive, contrived and artificial arrangements
- In UK, GAAR is applied in exceptional cases where there is clear evidence of an extremely aggressive arrangement to escape tax
- Onus lies on revenue to establish the case for invocation of GAAR

GAAR : Interpretative principles

- Very strict interpretation
- Natural preference should be to rescue the assessee than uphold GAAR
- Every natural act does not come under GAAR
- Mere obtaining tax benefit is not sufficient unless coupled with tainted act

GAAR

Nature of mandate

GAAR : Nature of mandate

- There is no mandate on assessee not to get into IAA.
- Entering into IAA is not barred by law.
- It is only at the instance of AO, can an arrangement be declared as IAA.
- Assessee is not bound to suo motu declare his arrangement as IAA.
- It is not like sec 92 which creates a suo motu mandate.
- It is more like section 14A read with Rule 8D which can be invoked only at the instance of revenue : **Holcim India P Ltd** Delhi HC 2014-TIOL-1586-HC-DEL
- **Thus , there cannot be penalty when GAAR is invoked**

GAAR

V.

SAAR

AAR

GAAR

SAAR

1. Sec 40A(2)
2. Sec 94
3. Sec 94A (NJA)
4. Sec 92 (TP Provisions)
5. Chapter V (Clubbing)
6. Sec 68 to 69D
7. CFC, Thin Capitalisation, Exit tax, LOB
8. Section 9

Note:

1. Mutual Notwithstanding
2. Section 100

Chapter X-A

v.

Sections 4 & 5

Chapter X-A v. sections 4 & 5

1. GAAR provisions do not override or militate against sections 4 and 5. It may override only section 90.

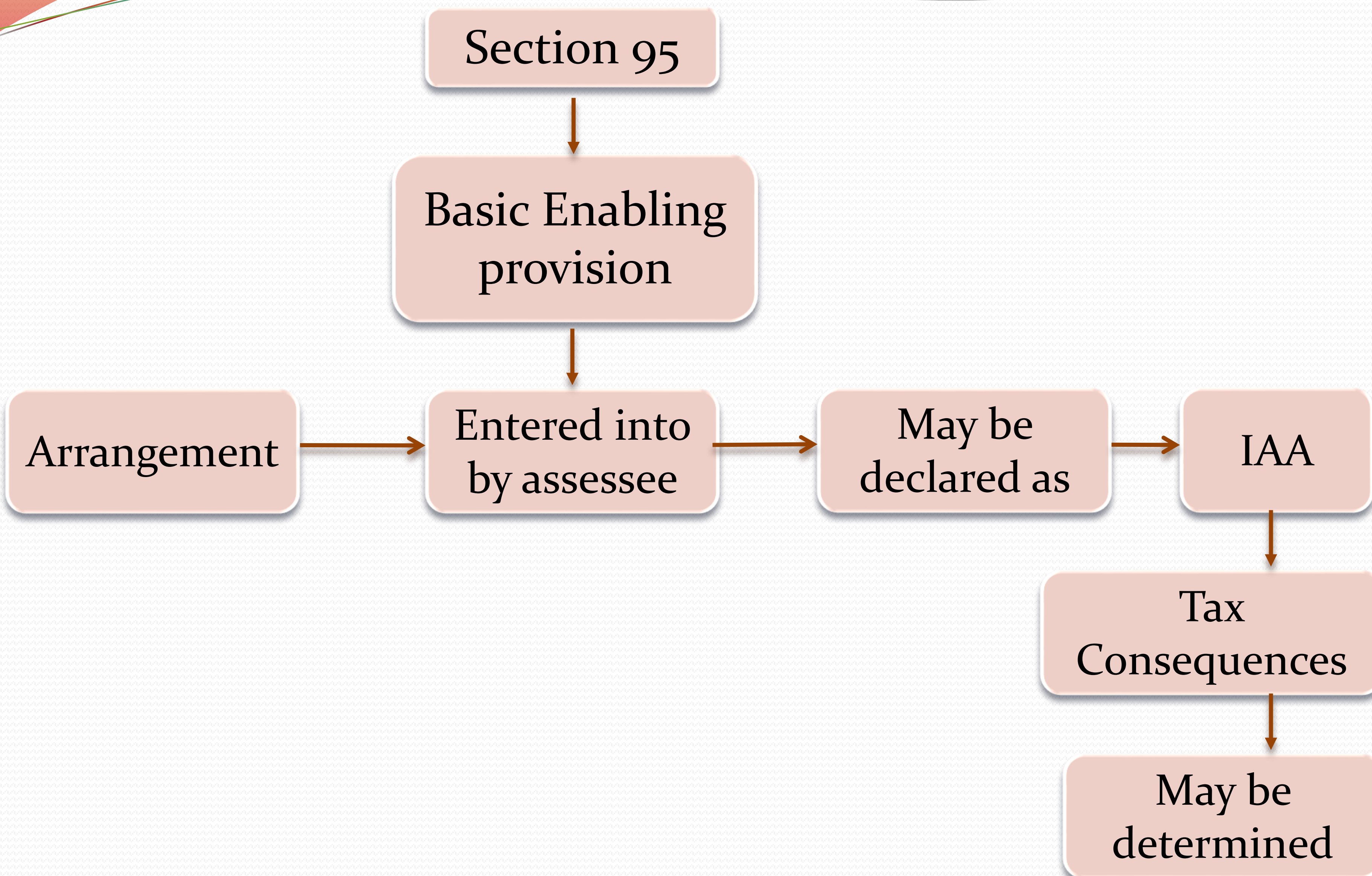
2. Section 98(2)(ii) permits AO to treat a capital accrual as a revenue accrual. Does it thus permit him to convert a non income as an income?

3. However, he cannot advance the accrual or make non accrual an accrual

4. Can he shift the attributes of section 5 between different persons? – Section 98(1)(e) permits him to reallocate receipts between parties to arrangement?

SECTION

95


Section 95
Basic Enabling provision
Arrangement
Entered into by assessee
May be declared as
IAA
Tax Consequences
May be determined

TB → S. 102(10) → Means

(a) Reduction/avoidance/deferral of tax/other amount payable under IT Act

(b) Increase in refund of tax/other amount under IT Act

(c) Reduction/avoidance/deferral of tax/other amount under IT Act as a result of DTA

(d) Increase in refund of tax/other amount under IT Act as a result of DTA

(e) Reduction of total income

(f) Increase in loss

In the relevant PY or any other PY

Tax Benefit : Some aspects

1. Tax benefit to whom?
2. Section 96(1) deals with TB simplicitor
3. Section 97(1)© deals with TB to any party
4. Section 97(3) deals with TB to the assessee
5. Does tax benefit include the liability under section 201(1) or interest under section 201(1A) or penalty under section 271C

Tax Benefit : Some aspects

1. When under MAAT, reduction in normal total income cannot come under clause (e)

2. Similarly, when under normal regime, reduction in book profit cannot come under clause (e)

3. When there is reduction in tax as well as in total income, are both clauses (a) and (e) attracted? Rule 10U(3)(iv) possibly provides answer by equating (a) with (e).

4. Deferral : Eg : conversion of capital asset into stock under sec 45(2)

Tax Benefit : Some aspects

1. Section 102(10) considers tax or any other amount.

2. Any other amount like interest and penalty are inconceivable as tax benefit.

3. Therefore, Rule 10U(3)(iv) rightly considers only tax

Certain important points

- Notwithstanding effect
- ‘May be’ vs. ‘shall be’ – 237 ITR 570 (SC)
- IAA - ‘May be’

  TC - ‘May be’
- TCs don’t follow but need to be determined

Extent of applicability of GAAR : Sec 95 Explanation

1. Chapter X-A may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement

2. 'may be' has two connotations : As 'may be' to indicate discretionary nature of GAAR application, as 'shall be' to indicate restrictive nature of its application only to step in or part of the arrangement.

3. Rule 10UA : Where a part of an arrangement is declared to be an IAA, the consequences in relation to tax shall be determined with reference to such part only

4. Above are clarificatory as sec 102(1) defines arrangement to include a step in or a part or whole of any transaction

Section 95

- When several parties enter into arrangement and some only get the tax benefit, AO of which party would initiate GAAR?

- The scheme of section 144BA would apply only to the assessee whose AO has invoked GAAR and tax consequences would be determined only for him

- For other parties, there is no enabling provision to determine the tax consequences.

- Can section 147 be invoked in respect of other parties when they have not participated in sec 144BA proceedings

EFFECTIVE DATE

Effective from 01.04.2018

- Prospective or Retrospective
- Applicable for AY 2018-19
- GAAR – Substantive vs. Procedural
- Rule 10U(1)(d) and Rule 10U(2)

GRAND FATHERING

Rule 10U(1)(d) and Rule 10U(2)

1. Rule 10U(1)(d) : Chapter X-A does not apply to any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from any transfer [,] of investments made before the 1st day of April, 2017 by such person

2. Rule 10U(2) provides that without prejudice to Rule 10U(1)(d), Chapter X-A shall apply to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained [,] from the arrangement on or after 1.4.2017

Rule 10U(1)(d) and Rule 10U(2)

1. Rule 10U(1)(d) and Rule 10U(2) have serious syntax errors.

2. Rule 10U(1)(d) and Rule 10U(2) would require 'comma' to be put so as to convey the intention clearly.

3. Shome Committee clearly recognises grandfathering of investments and not arrangements

Effective from 01.04.2018

- ICAI's recommendation [SCR] :

  Government may consider providing for a maximum period (say, 12 months from date of filing of tax return) within which the CIT should seek to invoke GAAR

- Ministry's Response

  Such a time limit cannot be provided as the tax avoidance arrangement may pertain to more than one year. The tax authority is required to invoke provisions of GAAR as and when relevant information comes to his notice.

Effective from 01.04.2018

- FICCI's recommendation [SCR] :

The tax authorities should be restricted from invoking the provisions of GAAR during the course of reassessment proceedings and should also be prohibited from initiating reassessment proceedings by invoking GAAR.

- Ministry's Response

  As GAAR is intended to deal with impermissible avoidance arrangement, which may have impact over several years, placing this type of restriction is not feasible

GAAR not to apply

Rule 10U(1) : Chapter X-A not to apply to

a. An arrangement where the tax benefit in the relevant AY arising, in aggregate, to all the parties to the arrangement does not exceed Rs.3 Cr

b. FII

c. Non resident in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a FII

d. Income from transfer of investments made before 30.8.2010

Rule 10U(1)(a) : Implications

- Meaning of 'in aggregate'

- Are tax benefit to one party and tax sacrifice by other party to be set off? – Does not appear to on the basis of definition of Tax Benefit as per section 102(10)

- Use of 'relevant assessment year' might negate the entire chapter whereas sec 102(10) USES 'in the relevant previous year or any other previous year'.

- Example 1 : In the case of IAA where the TB is Rs.6 crores but spread equally over three years

Rule 10U(1)(a) : Implications

- Example 2 :

Year	Arrangement	TB	Tainted Act
1	Step in	No	No
2	Part 1	No	Yes
3	Part 2 [final part]	10 Cr	No

- GAAR will fail even if sec 96(2) is applied as there is no TB in Years 1 & 2, if each part is called IAA
- However, if entire arrangement is called IAA, result would be different

Rule 10U(1)(a) : Implications

- Section 144BA(6) provides for declaration of IAA for one or more previous year : This stands nullified by Rule 10U(1)(a) for those P Ys where TB<Rs.3 Cr.

- Section 144BA(11) which permits the AO to determine tax consequences of other PY without seeking reference is also subject to Rule 10U(1)(a)

- Tax benefit as defined in sec 102(10) is diluted by tax benefit as defined in Rule 10U(3)(iv)

TB → S. 102(10) → Means

(a) Reduction/avoidance/deferral of tax/other amount payable under IT Act

(b) Increase in refund of tax/other amount under IT Act

(c) Reduction/avoidance/deferral of tax/other amount under IT Act as a result of DTA

(d) Increase in refund of tax/other amount under IT Act as a result of DTA

(e) Reduction of total income

(f) Increase in loss

← In the relevant PY or any other PY

Rule 10U(3)(iv)

"tax benefit" as defined in clause (10) of section 102 and computed in accordance with Chapter X-A shall be with reference to-

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

(b) sub-clause (f) of the said clause, the tax that would have been chargeable had the increase in loss referred to therein been the total income.

Section 102(10) v. Rule 10U(3)(iv)

- While sec 102(10)(e) considers reduction in total income, rule 10U(3)(iv)(a) limits it to the amount of tax
- While sec 102(10)(a) to (d) consider tax or any other amount, rule 10U(3)(iv)(a) limits it to the amount of tax only.
- Therefore, rule 10U(3)(iv)(a) significantly reduces the scope for application of GAAR

GAAR

V.

DTA

GAAR v. DTA

1. Section 90(2) provides for opting for IT provisions only when more beneficial

2. Position judicially recognised in 263 ITR 706 SC and 267 ITR 654 SC

3. Section 90(2A) provides that notwithstanding anything contained in sec 90(2), provisions of Chapter X-A to apply to the assessee, even if such provisions are not beneficial to him

GAAR v. DTA

4. Specific LOB clauses in certain DTAs – Ministry's reply to IBA's concern and ICAI's concern [SCR]

   Limitation of benefit clause as available in India's DTAAs has limited application and would not cover all the cases/circumstances which would be covered through GAAR.

5. Proposed section 90(4) – LOB in IT Act

6. Is GAAR unilateral in defying Treaty's supremacy?

GAAR

V.

RECIPROCAL ADJUSTMENT

GAAR v. RECIPROCAL ADJUSTMENT

1. Article 9(2) provides for reciprocal adjustment

2. Section 92(3) bars favourable TP adjustment

3. Second Proviso to section 92C(4) bars reciprocal adjustment to the receiver

4. Chapter X-A is silent on reciprocal adjustment

GAAR v. RECIPROCAL ADJUSTMENT

1. Reciprocal adjustment whether situational or universal

2. Reciprocal adjustment within same tax jurisdiction

3. Reciprocal adjustment across different tax jurisdictions

- Where DTA provides
- Where DTA does not provide

GAAR v. RECIPROCAL ADJUSTMENT

1. Shome Committee says no reciprocal benefit to other parties but self adjustments are permissible

2. Section 144BA(7) recognises that directions prejudicial to revenue may be issued : By implication, it recognises reciprocal benefit.

GAAR v. RECIPROCAL ADJUSTMENT

5. FICCI's [SCR] recommendation

In cases where the tax authorities seek to invoke GAAR in the hands of one taxpayer, the corresponding relief should be granted to the other party to the transaction/ arrangement. To illustrate, the tax authorities could seek to recategorise dividends in the hands of one taxpayer as interest, thereby increasing the tax payable of one taxpayer without granting a corresponding deduction to the entity paying the dividend. In such cases, the corresponding deduction of interest expense should be granted to the other party.

Ministry's response

Even under the current law, the corresponding adjustment due to application of a anti-abuse provision is not provided

CASES FOR RECIPROCAL ADJUSTMENT

1. Equity v. Debt [Interest v. Dividend]
2. Ignoring accommodating party
3. Treating accommodating party and any other party as one and same
4. Disregarding/combining/recharacterizing IAA
5. Reallocating income /expenditure /deduction/ relief /rebate
6. Treating connected parties as one and same

GAAR

V.

AAR

GAAR v. AAR

1. Sec 245N(a) (iv) : Advance ruling means *a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not*

2. Sec 245N(b) (iiia) – Applicant means any person who is referred to in Sec 245N(a) (iv)

GAAR v. AAR

1. Proviso (iii) to sec 245R bars AAR from entertaining an application relates to a transaction or issue which is ***designed prima facie for the avoidance of income-tax*** [except in the case of a resident applicant falling in sec 245N(b)(iii)/(iiia)]

2. Will GAAR apply to arrangement approved by AAR? – Ministry's reply to IBA's concern [SCR]

   The AAR gives rulings only in cases where the transaction is not part of the avoidance arrangement

GAAR v. AAR

3. Sec 245S(1) : A ruling is binding only—

(*a*) on the applicant who had sought it;

(*b*) in respect of the **transaction** in relation to which the ruling had been sought; and

(*c*) on CIT and IT authorities subordinate to him, in respect of the applicant and the said transaction.

4. Section 245N(1)(iv) relates to arrangement whereas section 245S(1) relates to transaction.

GAAR v. AAR

Can GAAR be invoked for advance ruling obtained in earlier AY?

Section 245S(2) provides advance ruling as binding unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

IMPERMISSIBLE AVOIDANCE

ARRANGEMENT (IAA)

Section 96

IAA

Arrangement 102 (1)

Main purpose/ one of the main purposes

AND

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

To obtain

Tax Benefit
Sec 102 (10)
Sec 99

Main Purpose of Step/ part = Main purpose of arrangement {Sec 96(2)}

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide Purposes.

Section 96(2)

1. An arrangement shall be presumed,
2. unless it is proved to the contrary by the assessee,
3. to have been entered into, or carried out, for the main purpose of obtaining a tax benefit,
4. if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit,
5. notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

Section 96(2) - implications

1. Deems main purpose of the transaction is to obtain tax benefit if main purpose of a part alone is to obtain the tax benefit

2. Contrary can be proved

3. Deeming is confined to first limb of sec 96(1) and is confined to tax benefit and not to extend to deeming the entire transaction as IAA

4. Section 102(1) should be ignored in interpreting sec 96(2) as otherwise it causes iteration

Section 96(2) - implications

1. Take an example of a transaction which has 4 parts. First three parts do not have main purpose of obtaining tax benefit whereas the last part has.

2. However, first three parts satisfy the second limb whereas the last one does not. This provision seems to be to take care of first three parts by fiction.

3. Alternatively, if the entire transaction is treated as one integrated transaction even for the purpose of sec 96(1), it would make even last part as IAA.

4. Will this militate against section 102(1) read with Explanation to section 95?

Some aspects of section 96(1)(a)

1. Rights or obligations not ordinarily created between persons dealing at arm's length

- Arm's length price v. Arm's length rights/obligations
- Creation v. Modification of rights and obligations

Example 1 : Purchase of business

- By paying Rs.60 as against FMV of Rs.100
- By creating a non compete for 5 years for no consideration

Example 2 : Sale and lease back

Some aspects of section 96(1)(a)

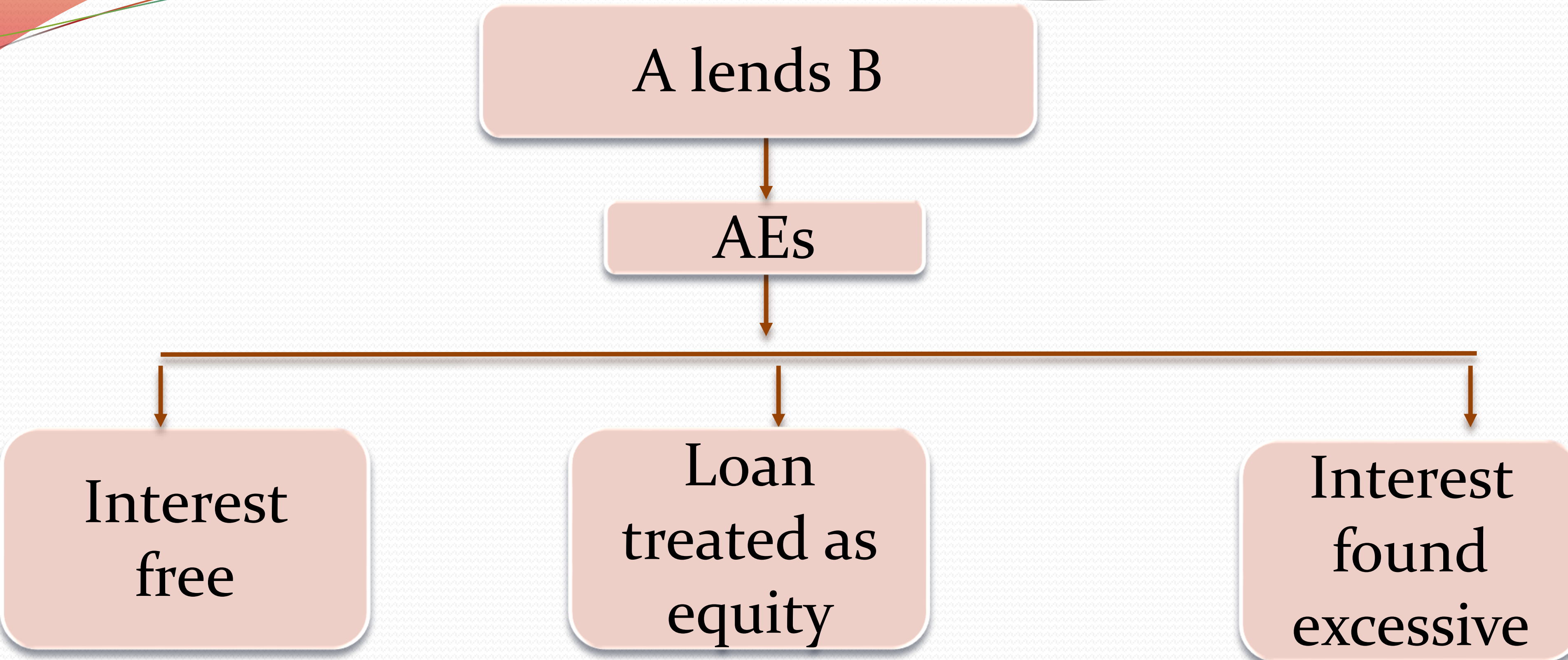
- In TP, controlled transactions are benchmarked with uncontrolled. However, here, even uncontrolled transactions are required to be bench marked with other uncontrolled transactions.
- In such case, transactions of A&B are benchmarked with C&D : What is the preference?
- Similarly, if there is controlled transaction [but not SDT], it may have to be benchmarked with another controlled transaction only – appears absurd!

Some aspects of section 96(1)(a)

- Does creation of right include sacrifice of a right?
- Are commercially imprudent decisions hit?
- JDAs and JVs may be under scanner
- Genuineness is not excepted

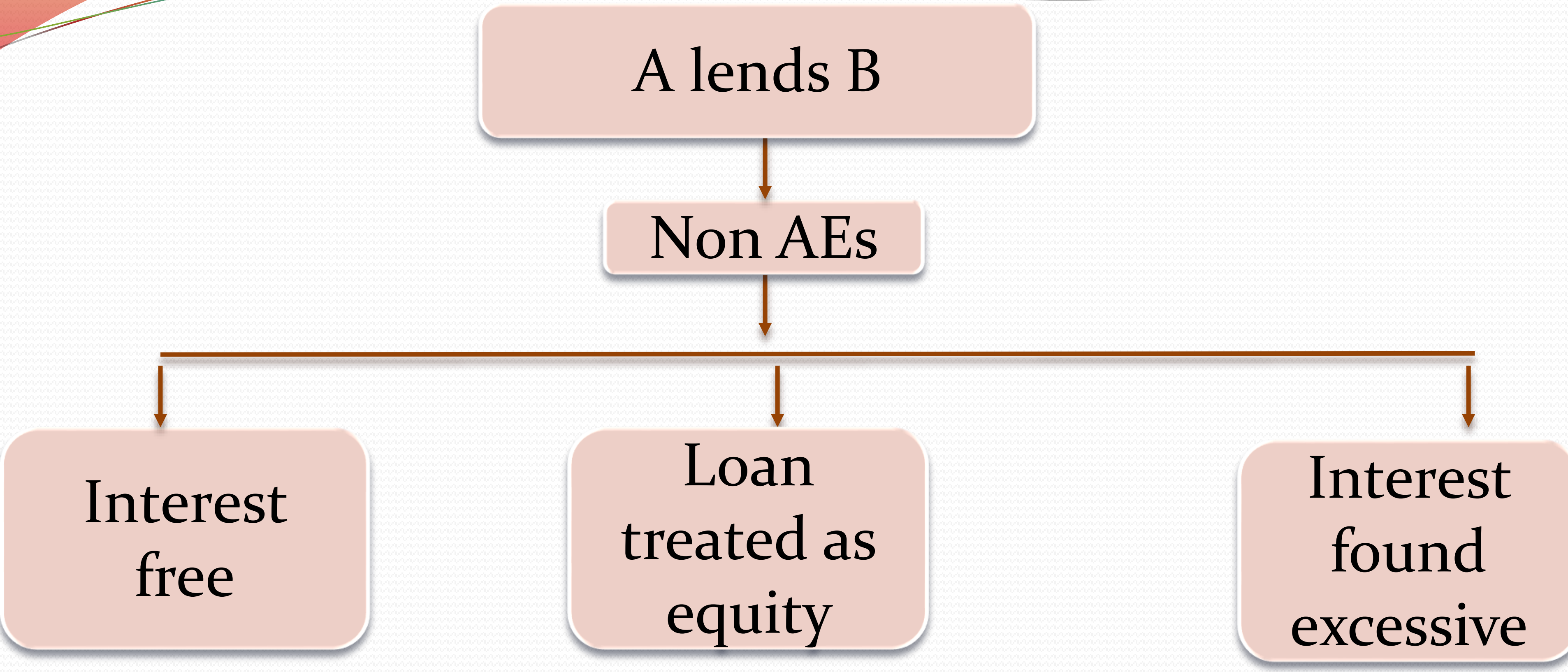
Examples of section 96(1)(a)

- A shareholding agreement SHA where majority holder gives supervening rights to minoriy
- Cross gifts/transactions to overcome clubbing and sec 56(2)(vii)
- Profit making group company making interest free loan to a loss making group company
- A company offering buyback to A, B and C where B & C reject the offer in favour of A for an unknown consideration.


A lends B
AEs
Interest free
Loan treated as equity
Interest found excessive

Implications

- SAAR v. GAAR
- If GAAR is invoked, B would be troubled but as there is no tax benefit, no implications on it.
- In terms of sec 144BA, A cannot be fastened with tax liability as A has not participated in the tax proceedings.
- TP on A – Vodafone 368 ITR 1 Bby v. **Instrumentarium Corporation [TS-467-ITAT-2016(Kol)-TP]**


A lends B
Non AEs
Interest free
Loan treated as equity
Interest found excessive

Implications

- If A charges 20% instead of 15% being normal, can GAAR be invoked
- Is interest payment a step in or a part?
- If step in, part of step in is not an arrangement. Hence, GAAR does not apply.
- If interest payment is a part, excessive portion is part of a part.
- Part of a part is inconceivable to be a part hence is not an arrangement.

Some aspects of section 96(1)(b)

2. Use v. Misuse/abuse : Use is not misuse or abuse as per 326 ITR 1 SC

- Cross gifts to overcome sec 64 is abuse
- Using partially gift route to overcome sec 79 is abuse

3. Bonafide – Is not bonafide equal to malafide?

4. Bonafide purpose qualifies the means/manner of entering into/carrying out the arrangement and not the purpose of the arrangement as a whole

Examples of section 96(1)(b)

- Sale cum lease back v. Lending
- Purchase of MF units on 2^{nd} and sale on 29^{th} to overcome Rule 8D
- Take a huge loan from employer and have a credit facility with bank to fund repayment at month ends – pay interest for 12 days and enjoy tax free perk for rest of year
- Individual gifting house to spouse who would use it as SOP and nil income is clubbed.
- Individual gifting houses to members in family to stay under section 54F

Examples of section 96(1)(b)

- Company with huge reserve [not covered under sec 47(xiiib) converting to LLP to later distribute the same without DDT.

- Overcoming time limits of section 94

Some aspects of section 96(1)(d)

- An arrangement is entered into or carried out, by means, or in a manner, which are not ordinarily employed for bonafide purposes

- Is bonafide = Lack of malafide

Examples of section 96(1)(d)

- Can thin capitalisation be brought under this clause?
- Where a property to be rented is given under English mortgage with possession for an interest free loan and interest not charged equates in substance rent
- Conversion of capital asset into stock where land owner is a mute participant in the JDA

Lacking Commercial Substance (LCS)

Actual

Relevant but no sufficient factors - S. 97(4)

1. Period/time for which arrangement (including operation therein) exits
2. Payment of taxes, directly/indirectly, under arrangement
3. Exit route (including transfer of any activity/business/operations) is provided by the arrangement

Deemed

Section 97(1)

Some aspects on LCS

1. Lacks commercial substance v. Inadequate commercial substance

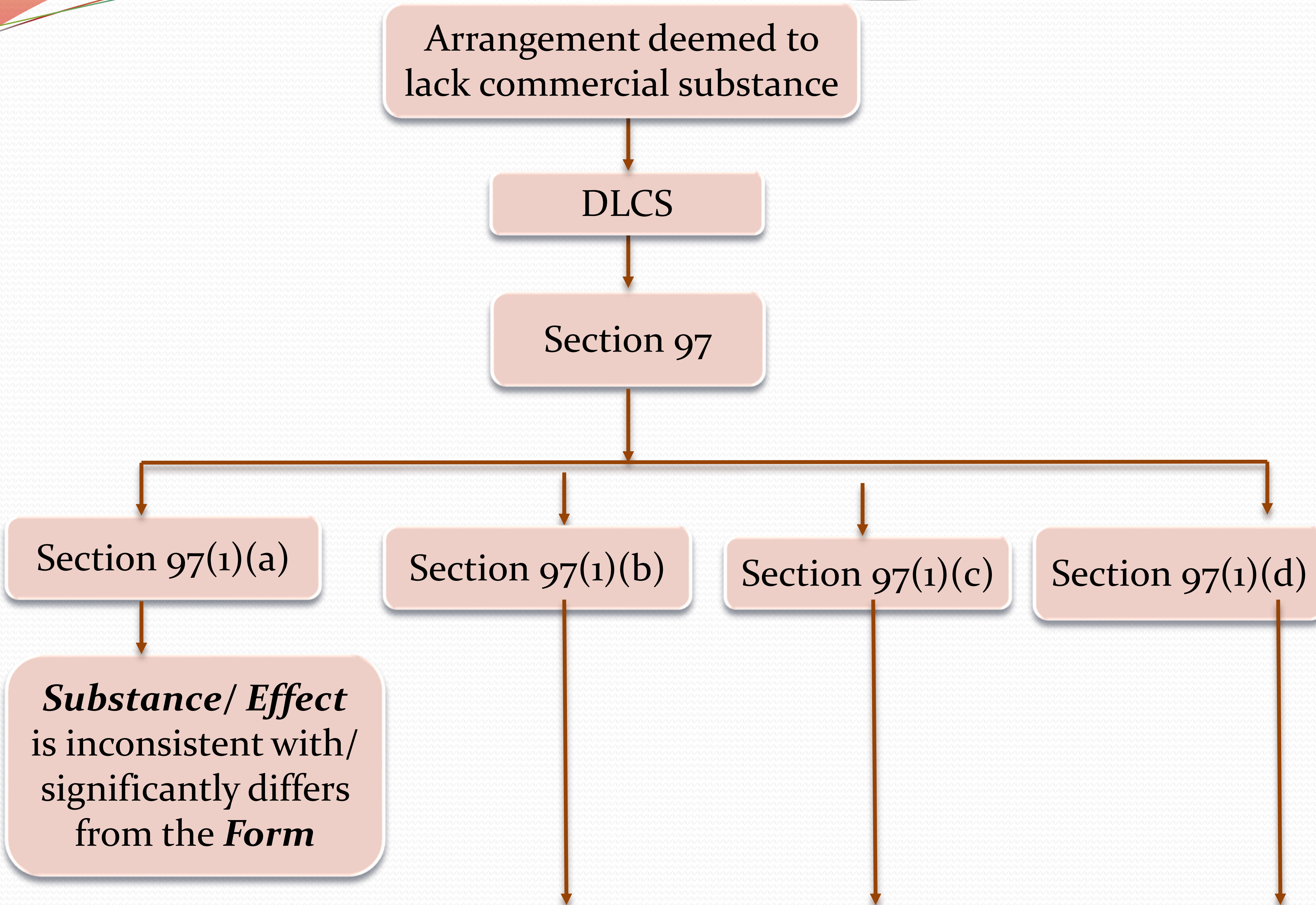
2. Words ‘wholly or in part’ are relevant

Notes to Section 97(4):

a) List of factors is exhaustive

b) It is a bar in a total sense. Short period/non payment also cannot be considered to hold that there is LCS.

c) This provision doesn't affect determination of SCP under Section 97(1)(c), Section 97(2)(b) and Section 97(3)


Arrangement deemed to lack commercial substance
DLCS
Section 97
Section 97(1)(a)
Section 97(1)(b)
Section 97(1)(c)
Section 97(1)(d)
Substance/ Effect is inconsistent with/ significantly differs from the ***Form***

Involves/includes

(i) RTF : Eg 6 & 7
(ii) AP : Eg 5B
(iii) Offsetting/cancelling elements
(iv) Disguising value/location/ source/ownership/control of funds

Involves location of asset/ transaction/ place of residence without SCP but only for obtaining a TB for a party

No significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained

RTF

S. 97(2)

Includes any arrangement in which

Through a series of transactions

Funds [S. 102(6)] are transferred among parties to arrangement

And

Such transactions have no SCP other than obtaining TB [S. 102(11)]

Without regard to

Whether or not

(a) Funds involved can be traced to funds transferred to/received by any party in connection with arrangement

(b) Time/sequence in which funds are transferred/received

(c) Means/manner/mode in which funds are transferred/received

Notes:

a) Arrangement $\longrightarrow$ RTF $\longrightarrow$ Arrangement

b) LCS v. SCP

c) SCP is not defined

AP

S. 97(3)

For purpose of Chapter X-A

A party who

Whether or not a connected person to any party to arrangement

Participate s directly/indirectly and wholly/partly in arrangement for the

Main purpose of obtaining, directly/indirectly

A TB for the assessee

TAX

CONSEQUENCES

Tax Consequences

Section 98

Means

Consequences in relation to tax, of the arrangement

including

Denial of
(a) Tax benefit
(b) DTA Benefit

Shall be determined

In such manner as deemed appropriate

Including by way of (but not limited to)

a) disregarding, combining or recharacterising any step in, or a part or whole of, the impermissible avoidance arrangement

b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out

c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person

d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount ….

e) reallocating amongst the parties to the arrangement—

(i) any accrual, or receipt, of a capital or revenue nature; or
(ii) any expenditure, deduction, relief or rebate;

f) treating—

(i) the place of residence of any party to the arrangement; or
(ii) the situs of an asset or of a transaction,

at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

g) considering or looking through any arrangement by disregarding any corporate structure.

Manner of determining Tax Consequences

May include [Section 98(2)]

a) any equity may be treated as debt or vice versa

b) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

c) any expenditure, deduction, relief or rebate may be re-characterised

For determining

↓

Whether TB exists (Section 99)

↓

(i) the parties who are connected persons in relation to each other may be treated as one and the same person

(ii) any accommodating party may be disregarded

(iii) such accommodating party and any other party may be treated as one and the same person

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

Notes:

a) Tax benefit exists :

As a purpose → Section 96
As a reality → Section 98

b) Section 99 (ii) supports that Section 99 applies only for purpose of Section 98 and not for Section 96

c) Corporate structure – Does it include firm/LLP?

d) Considered v. looked through – A surplusage!

PROCEDURE

Section 144BA

AO

a) Makes reference to CIT – S. 144BA(1)

b) Where direction of AP relates to any PY, AO to proceed as per directions/Chapter X-A without having to make reference to AP for such PY – S. 144BA(11)…

Commissioner

a) Issues notice to assessee – Section 144BA(2)

b) Issues direction, if assessee doesn't object – S. 144BA(3)

c) If not satisfied with objection, refers case to AP – S. 144BA(4)…

Approving Panel

a) Issues direction upon reference – S. 144BA(6)

b) Hearing to be granted – S. 144BA(7)

c) Power to cause further enquiry, call for & examine records…

c) Pass assessment/re assessment order to give effect to tax consequences – S. 144BA(12)

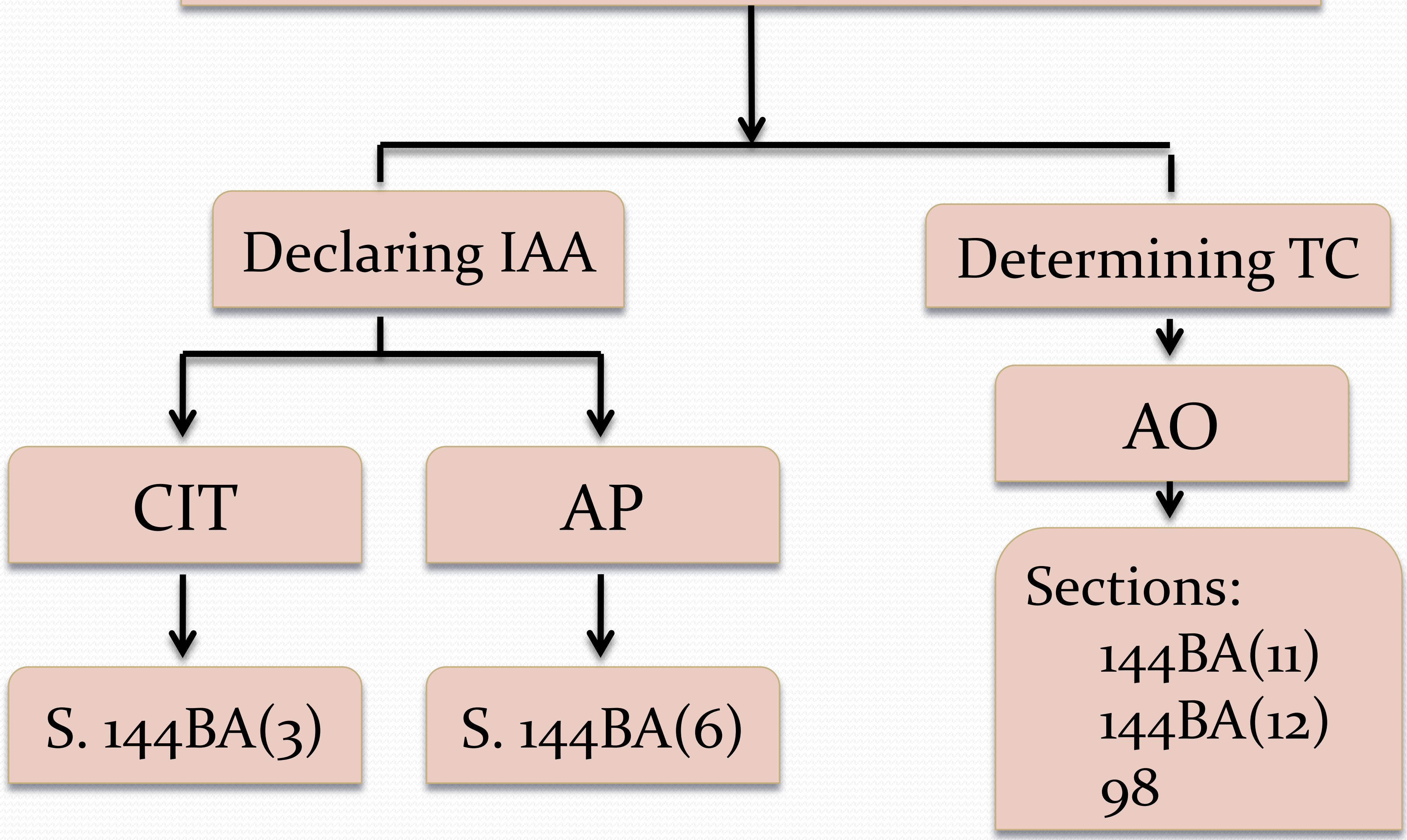
d) If satisfied, passes an order dropping proceeding – S. 144BA(5)

e) Grants prior approval to order passed under S. 144BA(12)

d) Decision by majority – S. 144BA(9)

e) Directions are binding on AO – S. 144BA(10)

Role of AO/CIT/AP



CONCERNS

GAAR CONCERNS EXPRESSED BY VARIOUS BODIES

1. The GAAR confers vast and discretionary powers to the tax authorities to disregard any business transactions including for instance, a tax neutral merger, or holding company structures, especially those which involve countries with which India has entered into favourable tax treaties. This would lead to significant uncertainty with respect to conducting business in India.

2. A tax treaty override (without any objective parameters) under GAAR could raise concerns about the sanctity of benefits conferred under treaties and affect India"s credibility as a reliable treaty partner.

3. Structures that are currently in place could potentially be challenged under the new legislation causing significant hardship to existing investors.

GAAR CONCERNS EXPRESSED BY VARIOUS BODIES

4. The application of GAAR to a specific structure by the tax authorities could change from year to year, resulting in significant fiscal uncertainty.

5. Transactions/ structures that have been specifically upheld by Courts could also potentially be targeted under the GAAR.

6. The GAAR could lead to cumbersome, time-consuming and costly litigation each time a transaction or structure is sought to be tested under the GAAR by the tax authorities.

ASSURANCES

Ministry's assurances [SCR]

1. It is not a revenue raising measure but is there to prevent loss of revenue [para 15.31]

2. A mere tax benefit under DTA would not lead to application of GAAR unless other conditions prescribed are also fulfilled [para 15.31]

3. Since GAAR would be operational under a set of guidelines framed by CBDT, there should be no cause for concern in this regard. [para 15.33]

4. Further, the guidelines to be prescribed shall also be placed in the public domain before finalization [para 15.33]

Ministry's assurances [SCR]

5. A reasonable threshold limit for invoking GAAR to be prescribed

Assurance in the Memorandum to Finance Bill

1. The basic criticism of statutory GAAR which is raised worldwide is that it provides a wide discretion and authority to the tax administration which at times is prone to be misused.

2. This vital aspect, therefore, needs to be kept in mind while formulating any GAAR regime.

STANDING COMMITTEE

RECOMMENDATION

Standing committee recommendation – Para 15.35

1. In view of the apprehensions expressed by different stakeholders on the applicability of GAAR proposals, the Committee would recommend that the Ministry and the CBDT should seek to bring greater clarity and preciseness to the scope of the provisions.

2. There should be certainty on these provisions so that foreign investors do not become wary of investing in the country.

3. The conditions dealing with “misuse or abuse of DTC provisions” and the “manner applied for the arrangements not for bona fide business purpose” and “lacks commercial substance”, being very widely worded and being subjective, need to be more specifically defined to avoid undue discretion to tax authorities.

Standing committee recommendation – Para 15.35

4. In the Committee's view, the onus should rest on the tax authority invoking GAAR and this should not be shifted to the taxpayer.

Summary of recommendation

1. The provisions to deter tax avoidance should not be end up penalizing tax- payers who have genuine reasons for entering into a bonafide transaction.

2. Frivolous cases should be avoided for which a threshold may be prescribed under the Rules.

3. It has been proposed that the orders of the Commissioner invoking GAAR provisions will be subject to approval of Dispute Resolution Panel (DRP) which is a collegium of three Commissioners of Income Tax.

Summary of recommendation

4. Since this is a purely departmental body, it will be fair and just if the review is done by a more independent body. The DRP should give ample opportunity to the assessee to present his case. The Assessing Officer should record his reasons, in writing, before passing the order invoking GAAR.

5. Further, the DRP should be headed by a Chief Commissioner of Income Tax and two other Members who will be independent technical persons.

Summary of recommendation

6. A threshold limit for specific amount of tax may be prescribed for application of GAAR, which may be reviewed with experience.

7. It would also be fair to apply GAAR provisions prospectively so that it is not made applicable to existing arrangements/transactions. Alternatively, suitable grandfathering provisions may be made to protect the interest of the tax- payers who have entered into structures / arrangements under the existing law.

8. Tax-payers may also be permitted to obtain an Advance Ruling to determine whether any kind of transaction would fall within GAAR.

Summary of recommendation

9. Clause 123(1) of the Code seems to suggest that while invoking GAAR provisions, the entire arrangement may be declared as "impermissible arrangement". It thus needs to be clarified that only that part of the arrangement would be invoked which is proved as "impermissible".

10. Uncertainties with regard to applicability of tax treaty provisions should be removed so that India's credibility as a reliable treaty partner is not affected.

11. The proposals should not lead to any fiscal uncertainty or ambiguity. It should be ensured that any of the proposals does not pave the way for avoidable litigation, which is already at a very high level in tax matters.