



Clarifications on Implementation of the General Anti-Avoidance Rule under the Income-tax Act, 1961

The Central Board of Direct Taxes (CBDT) has released a Circular¹ providing certain clarifications on the implementation of the General Anti-Avoidance Rule (GAAR). The Circular reiterates that GAAR will come into force with effect from 1 April 2017 and addresses 16 questions relating to GAAR. The key principles emerging from the responses are as under:

- The provisions of GAAR and specific Anti-Avoidance Rules (SAAR) can co-exist and will be applicable as may be necessary, depending upon the facts and circumstances of each case. The Shome Committee had recommended that where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/element.
- Anti-abuse rules (such as Limitations on Benefits (LoB) conditions) in tax treaties may not be sufficient to address all tax avoidance strategies, and hence these may need to be tackled through GAAR. However, if avoidance is sufficiently addressed by LoB in the treaty, then there may be no occasion to invoke GAAR.
- GAAR will not interplay with the right of the taxpayer to select or choose the method of implementing a transaction. In this context, it may be relevant to note that the Shome Committee had recommended that a detailed 'negative' list of transactions to which GAAR would not apply should be released.
- If the jurisdiction of a Foreign Portfolio Investor (FPI) is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain a

¹ Circular no. 7 of 2017



tax benefit, then GAAR will not apply. It is also stated that GAAR will not be invoked merely on the ground that an entity is located in a tax efficient jurisdiction.

- Shares which come into existence post 1 April 2017 from investments made in compulsorily convertible instruments before 1 April 2017 and with terms of conversion also finalised at the time of issue of such instruments, will be grandfathered. Similarly, bonus shares or shares obtained by way of split or consolidation of holdings in respect of shares acquired prior to 1 April 2017 will also be grandfathered.
- Arrangements such as lease contracts and loan arrangements will not fall within the ambit of 'investments', and hence will not be grandfathered.
- Where the Court/National Company Law Tribunal has explicitly and adequately considered the tax implications while sanctioning any arrangement, the provisions of GAAR will not be invoked. In contrast, the Shome Committee had recommended that amalgamations and demergers approved by the High Court should form part of the 'negative list' to which GAAR would not apply.
- Upon invocation of GAAR in the hands of a tax payer and specific consequences being applied in its hands, no corresponding tax adjustments will be made in the hands of other participant(s) since this might militate against the deterrence effect of GAAR.
- GAAR applies with respect to an arrangement or a part of an arrangement and hence, the limit of Rs. 30 million for invoking GAAR cannot be read in respect of a single taxpayer only.
- Where the Principal Commissioner/Approving Panel holds an arrangement to be permissible in one year, then GAAR will not be invoked for that arrangement in the subsequent year if the facts and circumstances remain the same.

Our Comments

Section 101 of the Income-tax Act, 1961 provides that the provisions of GAAR will be applied in accordance with prescribed guidelines. Although this Circular deals with several issues that one would have expected to be covered in the guidelines, it is not clear whether any further guidelines under section 101 will be released. Having said that, unlike in the case of the draft report issued by a Departmental Committee and the Shome Committee in 2012, no examples relating to the applicability of GAAR have been released yet. These will be of much help in understanding the scope of the legal provisions, particularly on issues such as the 'misuse or abuse' test, the 'commercial substance' test, etc. More clarity on how the consequences of GAAR will be determined and applied in specific instances will also be useful.



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